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INSURANCE IN DEVELOPING COUNTRIES: AN ASSESSMENT AND REVIEW OF DEVELOPMENTS (1989-1993)

Report by the UNCTAD secretariat

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ABBREVIATIONS

AIO	African Insurance Organisation
ALADI	Latin American Integration Association
ASEAN	Association of South East Asian Nations
CACM	Central American Common Market
CICA	Conférence International des Contrôleurs d'Assurance Africains
CIMA	Conférence Interafricaine des Marchés d'Assurance
EAIC	East African Insurance Conference
ECOWAS	Economic Community of West African States
EEC/EC	European Economic Community
ESCAP	Economic and Social Commission for Asia and the Pacific
FAIR	Federation of Afro-Asian Insurers and Reinsurers
FIDES	Federacion Interamericana de Empresas de Seguros
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
IMF	International Monetary Fund
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economical Cooperation and Development
PTA	Preferential Trade Agreement
TWIC	Third World Insurance Congress
UNESCO	United Nations Educational, Scientific and Cultural Organisation
UNDP	United Nations Development Programme

INTRODUCTION

(i) The eighth session of UNCTAD, held at Cartagena in February 1992, resolved to give a new direction to the work of UNCTAD as expressed in the Cartagena Commitment (TD/364). Following the new approach adopted by the Conference, it was decided to suspend the existing main Committees of the Trade and Development Board, including the Committee on Invisibles and Financing related to Trade (CIFT), one of whose two sessions was devoted to insurance. The work on insurance was incorporated in that of the newly created Standing Committee on Developing Services Sectors: Fostering Competitive Services Sectors in Developing Countries. In implementing the decisions of UNCTAD VIII, the Trade and Development Board, at the second part of its thirty-eighth session, adopted the terms of reference of the Standing Committee (Board decision 398(XXXVIII)).

(ii) Paragraph 4 of these terms of reference applies to insurance, asking the Committee "to analyze prospects for developing and strengthening the insurance sector and enhancing the trade of developing countries in this sector." In addition, paragraph 1(a) of the terms of reference asks the Committee to focus on a "review of the development of services sectors in developing countries and comparative analysis of policies, including identification of domestic weaknesses and capabilities, aimed at creating the conditions necessary for the development of competitive service sectors and export of services." The preparation of the present assessment and review is in line with this objective.

(iii) The work programme of the Standing Committee in the field of insurance, established at its first session on Insurance from 1 to 5 February 1993, requests the Committee under part "A. Promoting Transparency" to "... collect information on insurance operations, markets and experiences... through... a review of developments in insurance and reinsurance; and disseminate the results." The provisional agenda, established at the same session for the Committee's second session, requests the preparation of the "Review of developments in the insurance market (UNCTAD/SDD/INS/2/Rev.1)". The preparation of the present assessment and review is in line with this objective. As presented, the first revised version (Rev. 1) differs from the initial document tabled at the first session in that it includes developments from the later part of 1992 and up to the end of 1993. Consequently, certain analyses have been adjusted if insurance practice has rendered them over- or under-stated.

(iv) Some of the data used for the preparation of the review were supplied to the UNCTAD secretariat by the Governments of developing countries in response to a request made by the Secretary-General of UNCTAD. Other information has come from papers presented at international insurance conferences and meetings, which have been made available to the secretariat. Much of the information has been taken from trade journals and periodicals. The coverage of countries included in this survey has therefore largely depended on the information available in the professional press. It has of course not been possible to verify the accuracy of the information obtained in this way. Also, some of the information may be outdated and superseded by new developments by the time the review is published. It should be noted that when reference is made to specific insurance problems of developing countries, the statements made often apply only to a certain number of countries and not to all of them, since they are at different stages of development. Some problems may also be more widespread in one region or on one continent than elsewhere.

(v) The document is an assessment of the insurance markets of developing countries, with particular reference to the problems faced by them, and a general study of developments that have taken place during the period under review. Chapter I deals with the functioning of insurance markets and their structural development. Chapter II deals with insurance regulations and supervision. Chapters III, IV, V, VI and VII review the specific insurance lines of life, motor, fire, marine and transport, and export credit, political risks and other insurances respectively. Chapter VIII discusses offshore and captive insurance markets. Chapter IX discusses the important issue of insurance for natural catastrophes. Chapter X considers reinsurance in regard to developing countries, while chapter XI deals with international cooperation in insurance matters.

Chapter I

PROBLEMS AND NEW DEVELOPMENTS AFFECTING INSURANCE

A. Introductory remarks

1. The problems affecting insurance markets can be classified in two categories. The first consists of problems that arise from factors external to the insurance sector and relate to the general economic environment. The second concerns problems related to the practice of insurance itself, such as those deriving from a specific market structure, the level of skills and expertise present in the sector, underwriting factors and those associated with the evaluation of losses and settlement of claims.

B. Problems related to the general economic environment

Growth of insurance markets

2. The development and growth of the insurance sector in a country depends on the general level of economic development and prospects for the immediate future. Generally, there is a positive correlation between the economic development of a country and the amount people spend on insurance. In addition, the demand for insurance is influenced by the general price level, prices of insurance services, the aversion to risk and the specific social and political features of a country.[1]

3. From table 1 it can be seen that the share of developing countries in world total insurance increased from 3.9 per cent in 1988 to 5.8 per cent in 1991. This increase is accompanied by contrasting performances in individual regions, subregions and even countries. While Africa's share declined by more than 26 per cent, mainly because of decreasing premium volumes in the northern African countries, the share of Asia grew by 58 per cent, mainly due to sharp growth in premium volumes in the Republic of Korea and in the ASEAN countries. Latin America's share, after a steep fall in 1989, recovered almost to its previous levels. Changes in premium volumes were generally in line with the economic performance of the different regions, subregions and countries.

4. In Thailand in 1989, direct written premium grew by 39.4 per cent for non-life insurance following the strong economic boom.[2]

5. In Malaysia in 1989, the total written premium increased by 10.4 per cent while the GDP grew by 8.5 per cent.[3]

6. In the Republic of Korea in 1990, direct premium income in the non-life sector grew by 36.1 per cent for the whole year.[4]

Inflation

7. The level of inflation is a factor of great concern to the insurance industry in a number of countries. Conditions of high inflation result in depreciation of premium levels in real terms and create numerous problems for insurance companies. Very high levels of inflation or hyper-inflation may even render insurance inoperable.

8. In Argentina, where in the last years of the 1980s hyper-inflation peaked at 200 per cent a month, the value of insured properties could not be adjusted because there were no indexes that could predict price increases. For example, for motor insurance in 1989, although policies were invoiced every four months, a car's replacement value estimated a month before could not be used a month later to estimate

the total loss value, since that value would then be less than 50 per cent of the current price of a similar car. As a consequence the premiums charged were insufficient.[5]

9. In Peru, the 2,000 per cent inflation rate in 1988 as well as the associated movements in the foreign exchange rate made it difficult for insurers to provide cover in real terms. New regulations were adopted in December 1989 authorizing the use of US dollars specifically for insurance. It was anticipated that almost 90 per cent of the policies would be changed to US dollar denominations.[6]

10. In Guinea, currency devaluation and inflationary tendencies constituted one of the basic problems of the insurance industry.[7]

Table 1
Total insurance business

Regions/Subregions Countries	Premium volume in US$ billions 1988	1989	1990	1991	World share in per cent 1988	1989	1990	1991
World - Total	1,171.0	1,210.0	1,355.7	1,414.4	-	-	-	-
Developing Countries	46.0	50.9	61.8	82.2	3.94	4.20	4.56	5.81
of Africa	3.9	3.8	3.5	3.5	0.34	0.31	0.26	0.25
North Africa (Egypt, Libyan Arab Jamahiriya, Tunisia, Algeria and Morocco)	2.2	2.0	1.7	1.6	0.19	0.16	0.13	0.11
Sub-Saharan Africa	1.7	1.8	1.8	1.9	0.15	0.15	0.13	0.13
of Asia	33.5	40.0	48.9	63.8	2.86	3.31	3.61	4.51
ASEAN countries	3.8	4.6	5.6	6.8	0.33	0.38	0.42	0.48
India	2.7	2.6	2.8	3.9	0.23	0.21	0.21	0.28
China	3.5	3.6	4.6	3.3	0.30	0.32	0.34	0.23
Republic of Korea	16.5	21.3	27.4	31.7	1.41	2.02	2.02	2.24
of Latin America	8.6	7.1	9.4	14.9	0.74	0.58	0.70	1.05
Mexico	2.0	2.3	2.6	3.5	0.17	0.19	0.19	0.25
Brazil	1.0	1.2	2.5	4.3	0.09	0.10	0.19	0.30
Argentina	1.6	0.3	0.9	3.0	0.13	0.03	0.06	0.22
Venezuela	1.7	0.7	0.8	1.0	0.15	0.06	0.06	0.07
Chile	0.5	0.6	0.7	0.9	0.04	0.05	0.06	0.07

Source: SIGMA, Swiss Re, April 1990. February 1991, April 1992 and April 1993.

Development of financial markets

11. The inadequate development of financial markets and a lack of opportunities for safe, liquid, and well-diversified investments yielding reasonable returns inhibit the development of competitive insurance services, in particular life assurance.

12. In Senegal, insufficient investment opportunities for life assurance funds are the central problem hindering a stronger development of life assurance.[8] The lack of investment opportunities has even led some to argue that the principle of domiciliation of reserve funds should be reconsidered, and that life assurance companies in developing countries should be able to "invest outside their markets in order to guarantee their customers returns similar to those of their European competitors".[9]

Foreign exchange problems

13. The perennial problem of foreign exchange controls continues to affect insurers in [illegible]ain developing countries. In most of these countries exchange controls are put in place to regulate the flows of funds in hard currencies. These regulations take the form of restrictions on the remittance of funds abroad, including insurance and reinsurance premiums. Many insurers find it difficult to honour their obligations because of these regulations.

14. In Africa, insurers experienced many difficulties as a result of delays in obtaining the necessary allocation of foreign exchange for the settlement of reinsurance balances. Often these delays were due to a lack of the required foreign exchange, bureaucratic factors, or difficulties in complying with exchange control laws. In each case, the ceding companies in these markets were not able to pay their overseas reinsurers. The reinsurers in turn reacted, imposing stringent conditions and restrictive reinsurance terms, such as the unpopular premium payment warranty, which are generally detrimental to the interests of African ceding companies. Some international reinsurers raised the cost of reinsurance cover or imposed interest on reserves, while others offset claims or cash-loss payments against premiums owing to meet cash-loss requirements.[10]

15. In the Philippines "the difficulty in obtaining foreign exchange to service reinsurance obligations is one of the immediate problems and will be further complicated and accentuated by the recent reduction of remittances from the Philippine workforce in the Middle East, caused by the Gulf crisis."[11]

16. At the Casablanca African Insurance Reassessment Workshop of 1990, a recommendation specifically mentions that "African Governments should relax foreign exchange regulations in respect of reinsurance operations". The problem of foreign exchange is particularly acute in the case of large and sophisticated risks and marine insurance and reinsurance, as they are usually insured abroad.

Global approach to the financial services sector

17. Another development in the international insurance scene is the move towards an integration of banking and insurance in the financial services sector. This trend has also been observed in some developing countries with banks moving into insurance activities and insurers offering bank-related services, mostly to personal customers.

18. In Mexico, insurance entities may be integrated in general depositories, financial leasing institutions, factoring institutions and other financial activities.[12]

19. In Nigeria, free personal accident insurance cover is being offered by two banks. Certain insurers are complaining, but the banks state that they are only acting as agents for insurance companies.[13]

20. In India, both the Life Insurance Corporation and the General Insurance Corporation have extended their activities by establishing subsidiary companies dealing with housing, finance and mobilization of savings through mutual funds.[14]

21. Affiliation or direct ownership of insurance companies by banks is becoming common in Southeast Asia. Three banks in Malaysia, two in Singapore and one in the Philippines are involved in insurance operations.[15]

22. Privatization of insurance enterprises and liberalization of insurance markets are taking place in a large number of developing countries. These developments have a significant effect on the insurance sector. In view of their importance, a separate document deals with these subjects in depth.[16]

C. Problems related to insurance practice

The structure of insurance markets

23. Changes in the structure of insurance markets are being influenced by developments and reforms in the general economy and by specific action by government authorities in the field of insurance. In particular, with privatization and liberalization, market efficiency and performance are receiving greater attention than in the past.

24. Two dominant trends are discernible. On the one hand, monopolistic and oligopolistic market structures are being broken up. On the other, fragmented markets, often operating under conditions of cut-throat competition, cannot provide the high-quality and reliable services required by a modern economy. A higher degree of concentration may therefore increase their efficiency.

Concentration of markets

25. A number of developing countries have emphasized the importance of increasing market efficiency and providing better insurance services in addition to expanding business volume. "A higher concentration in the market could be achieved either through government intervention or as a result of market forces. Government action would entail a stricter supervisory system and higher capital and reserve requirements, thus obliging weaker companies to merge. Higher concentration could also be a consequence of policies aimed to strengthen market forces. In a competitive environment insurers with superior efficiency would offer products at better prices and a selection process would occur enabling them to improve their market share."[17] Concentration should not preclude commercial possibilities for smaller companies to function successfully in niche markets by specializing in specific lines of business.

26. In Chile the number of companies at the end of the 1980s was roughly one quarter the number in 1980 when the market was liberalized.[18]

27. In Argentina the market of 230 private and government insurers is fighting hard to survive with the overall premium estimated at about US$1.5 billion.[19]

28. Several country notes concerning the concentration of insurance markets follow:

Argentina: The 15 largest insurers (out of 230) wrote 50 per cent of the total premium.[20]

Brazil: The 10 top companies have a 72.8 per cent share of the market, and, compared with figures for the early 1980s, concentration is a growing reality.[21]

Chile: 80 per cent of the Chilean insurance markets is dominated by eight companies, but there is no cartel and there is a fairly high level of competition in the market.[22]

Mexico: In the non-life sector, 76.36 per cent of premium was produced by the six major companies.[23]

Philippines: The Commissioner of Insurance is reported to have stated that the top four companies wrote more than 75 per cent of the total premium income in the life sector. In the non-life sector, 25 companies wrote 70 per cent of the net total premiums, while the remaining companies are too small to compete and are actually not contributing to a competitive business environment.[24]

Singapore: The Insurance Commissioner has recommended to local insurance companies that they consider merging into larger entities for the benefit of both shareholders and insurance consumers.[25]

United Arab Emirates: Plans are being drawn up by the Ministry of the Economy to encourage mergers as the Emirates Insurance Association deems that there are too many insurance companies for the existing volume of business.[26]

Zimbabwe: Three Zimbabwean insurers will merge to form one company. The new company is expected to reap the benefits of economies of scale and provide a better use of resources and skills.[27]

Insurance professionalism and staff training

29. Insurance professionals in many developing countries have been complaining about the lack of public awareness of insurance. Despite its growth in recent years, the insurance industry has been suffering from an image problem. One reason may be a mistaken perception or misunderstanding of the role of insurance. Another could be a tendency for high pressure sales and insufficient emphasis on customer service. In his report to the Casablanca African Insurance Reassessment Workshop of 1990, a participant said "it is unfortunate to note that no African ever sets out, on his own, to purchase insurance cover. He has to be prompted to do so by either his bank, lawyer or the insurance salesman, who is generally regarded as a nuisance. Apart from the general lack of insurance awareness, the industry suffers from the problem that in most African countries insurance has a very poor public image."[28] The same Workshop concluded, inter alia, that it "regretted the general lack of insurance awareness in African countries and affirmed that it was of utmost importance that such awareness be enhanced so that the insurance sector could play more fully its vital economic and social role." It was also recommended that "national insurance associations should play a greater role in improving the public image of insurance, enhancing insurance awareness, self-regulation, establishing codes of conduct and in improving the relations between the industry, the public and the authorities."

30. During a seminar on motor insurance for the staff of ASEAN supervisory authorities, held in Kuala Lumpur in November 1991, it was reported that policyholders do not claim because of a lack of awareness or unsatisfactory past experiences with the system.[29]

Public image of insurance

31. There is no single prescription how to enhance the public image of insurance. A multi-dimensional approach might have to be adopted. Depending upon the specifics of the country situation, some actions would be identification, assessment and analysis of the real insurance needs, improved product design, efforts to explain the obligations of the insurer and the insured, improvement of the claims settlement procedure, and particularly a reduction of claims processing time.

Human resources development

32. The professionalism and motivation of people working in the insurance sector is a crucial factor. Increased emphasis on education in insurance through well-devised training programmes is necessary to improve the skills of the personnel.

33. Many insurance companies realize that, at a time of rapidly increasing competition and consumer expectations, the ultimate cost of not systematically training their personnel to match expected standards could be very heavy. Efforts have been made to implement training programmes for different categories of personnel. General staff, agents and the field force receive training to increase both their product knowledge and marketing skills. Many training centres organize programmes for the managerial cadre, particularly the middle management. The curriculum includes insurance, general management and behavioural science. Participation of senior managers in programmes for the junior staff would help to promote professionalism and corporate culture resulting in better team work in the office and improved client services.

34. The Seminar on Human Resources in the Field of Insurance, held at Lisbon in November 1990[30], made, inter alia, the following recommendations:

- Human resources development (HRD) responsibilities should be dealt with at the top management level;

- The HRD manager should take advantage of all opportunities to improve the industry's image with a view to encouraging better quality recruits;

- The insurance industry should be convinced that investment in HRD and adequate training capacities will provide benefits to the entire industry and a positive return on its investment.[31]

35. In the Arab/North African countries the "...insurance industry and market have as basic characteristics.. ..a general shortage of skilled insurance professionals..."[32]

36. The representative of Guinea to the Casablanca African Insurance Reassessment Workshop of 1990 reported that one of the basic problems of the insurance sector in Guinea was weak penetration of the market and a lack of insurance professionals.[33]

37. In the Philippines, one of the immediate problems facing the insurance industry is to develop technical qualities and abilities.[34]

38. In Malaysia, guidelines on duties and responsibilities of Directors and Chief Executives of insurers were issued to emphasize the need for insurers to be governed by professional and dedicated directors. A directive was issued requiring all insurers to spend at least one per cent of their previous year's gross salary cost on training to develop human resources to meet the increasing demand for suitably qualified and more professional manpower. Any shortfall below the minimum one per cent would have to be compensated by a payment into an Insurance Training Fund to finance training and education programmes for the benefit of the industry.[35]

39. It is reported that, in Nigeria, "a code of ethics and practice for the Nigerian insurance industry" was introduced in 1991. The code was drafted by the insurance industry as a measure of self regulation.

40. In Lesotho, determined efforts have been made to reduce the country's dependency on expatriate professionals and experts in general, especially in the insurance industry. A principle was introduced to the effect that if there is no national counterpart being trained to take over from an expatriate manager or expert within a reasonable time span, then the said manager or expert would not have his working permit extended.[36]

41. The Casablanca African Insurance Reassessment Workshop of 1990 recommended, inter alia, "that supervisory authorities should verify the honourability and competence of insurance managers."

Problems in insurance underwriting

42. Problems common to a number of developing countries include difficulties in the collection of premiums, inadequate rating systems, cash-flow underwriting, discounting and problems related to the level of commissions. Another major problem is the lack of statistical data needed to establish a competent rating structure. In many countries a sound statistical database would also be a good management tool.

Premium collection

43. Premium collection has become a serious problem in a number of countries. The preoccupation of many insurers with increasing their business volume led to the award of insurance covers to clients who were not able to make timely payment of their premium. The immediate consequence to the insurer was inadequate cash generation.

44. In Nigeria, despite legislation governing credit terms for insurance premiums, the amount owed to the insurance companies by brokers, agents and policyholders as of 1988 was approximately 40 per cent of the annual premium of the market.[37]

45. In Cameroon, amounts owed by clients and brokers would represent 70 per cent of the turnover.[38]

46. In Senegal, several companies are having difficulties caused by the non-payment of premiums, mainly in the agricultural sector. The increase of premium arrears is between 40 and 60 per cent.[39]

47. In Turkey, more than 45 per cent of the total premiums were overdue. This is creating tremendous cash-flow problems for Turkish insurers.[40]

48. Extending credit periods for the payment of premium by agents is a method used by some underwriters to try to encourage agents/brokers to secure more business, and can be an unsound marketing strategy.[41]

49. The principle of no-premium-no-cover has already been in existence in a number of countries, and there is a trend for its extension.

50. Such a system was introduced in Kenya in 1988 and has had a remarkable effect on the liquidity and cash flow of companies operating in Kenya. The conclusions of the Casablanca African Insurance Reassessment Workshop of 1990 recommended the introduction of the concept of "no-premium-no-cover".

51. It is reported that the new insurance decree in Nigeria, taking effect in 1992, specifies "no-premium, no-cover".

52. In Peru, a new regulation requires payment of premiums within a maximum of 20 days, plus bank interest, for policies in local currency. Policies written in US dollars can be paid in six-monthly instalments after making a 50 per cent down payment. The measures are aimed at restoring liquidity to insurers and minimizing the effects of inflation.[42]

53. In Morocco, following the decree of 10 November 1989, any premium or portion of a premium must be collected within a maximum of 30 days from its due date. This new premium payment requirement is designed to reduce the sums owed to insurance companies by intermediaries.[43]

54. In Malaysia, the "cash before cover" principle was introduced by which a cover note is issued only after premiums are collected. The principle of no-premium-no-cover needs to be supported by a set of

guidelines governing issues such as when the premium actually becomes payable, when it is allowed to be paid in instalments (e.g. Marine Hull and Construction All Risk insurance) and when the determination of the premium depends upon inspection of the risk and consequently cannot be quoted immediately (e.g. multiple and complex risks).

Rating systems

55. Controlling the rates to be charged through tariff systems is common in many developing countries. Political considerations, such as favouring a particular category of clients, have sometimes been the motivating factor. More important has been the perception that individual companies may not have the expertise to set fair and adequate rates or, in the absence of statistical data, may not be in the position to set rates which would properly reflect risk exposure.

56. After liberalization and deregulation, some countries have given up the system of tariffs, deeming that customers would derive benefits from more competitive rate-setting. Conversely, abandoning tariff rating has a number of problems. First, small and struggling companies may damage themselves and the market by unduly undercutting rates merely to gain some market share, without taking the long-term implications into account. Second, the absence of statistical data may make individual rating a subjective matter. Tariff rates for broad categories of risks and based on overall market experience, may be more appropriate. Third, deregulation may disadvantage individual clients with small and "mass" risks because consumer movements in many developing countries are either non-existent or weak and the terms and conditions for "mass" risks may require some monitoring by the authorities.

57. In many countries, tariff rates have not been recently revised, in some extreme cases for as long as 20 years, particularly for compulsory classes of business such as motor third party insurance. Compulsory insurance is often perceived as an imposition or tax rather than as a service. Thus, the public is very sensitive to variations in rates. The compulsory part of motor insurance constitutes a significant part of the total premium income and high-loss ratios in this department put a heavy strain on insurance companies. In many countries the insurance industry has been unable so far to rally sufficient support for an upward revision of tariffs because of its inability to substantiate the basis of its proposals with sound and detailed facts and arguments and because such moves are politically unpopular. When an overall profit is made for all insurance classes combined and high acquisition costs are still incurred, low rates for certain classes imply subsidization by other classes where rates are high. In these circumstances the insurance industry has often been unwilling to adjust rates downwards for lines where results were favourable. It is obvious that in such situations a sectoral adjustment of the rating structure may have to take place sooner or later. The introduction of a more competitive environment or a well planned and calculated strategy of reviewing all sections of the tariff structure may achieve this.

58. In the process of deregulation, many countries are considering the abolition of tariffs. In less developed insurance markets, the interest of the small and individual client requires some safeguards. Increased competition associated with privatization and liberalization may lead insurance companies to offer a wide variety of covers with marginal differences and varying prices, whose terms and conditions are difficult to compare for consumers who may not have sufficient experience in purchasing insurance and who would find it difficult to make a rational choice. For these markets the development of unsophisticated simple covers with standardized features may speed up claims processing and would also simplify the task of the supervisory authorities in monitoring the adequacy of the insurance services provided. All this would help to build up consumer confidence in insurance.

Enforcement of tariffs

59. In countries where tariffs are applied, their enforcement is often a problem. Many breaches of tariffs take place, a practice frequently advanced as an argument for their abolition.

60. In Puerto Rico, insurers trying to maintain market share have offered discounts up to 70 per cent below minimum tariffs for property/casualty policies, openly breaking the law. The capacity of many companies to meet future obligations has been severely impaired by uneconomic rates.[44]

61. In some African markets, there is a lot of rate-cutting, with the weak and so-called "mushroom" companies outdoing the bigger and better managed companies in the rate-cutting war. Since the mushroom companies have no intention of paying any claims, they have no difficulty in quoting low and unrealistic premium rates, to the detriment of the insurance industry.[45]

62. In the markets of the ASEAN countries, "not so easily detectible practices" such as higher commissions, no-claims discounts and even subsidizing selective overheads for agents or intermediaries have been noticed. Their purpose is to reward agents for securing larger shares of the market.[46]

Cash flow underwriting

63. In recent years a number of insurance markets in developing countries have suffered from reckless "cash flow underwriting", acquiring business for the sole purpose of deriving short-term benefits from the cash generated. This often meant incurring disproportionately high acquisition costs which heavily undercut premium rates and led to a neglect of sound underwriting principles. These practices not only endanger the long-term viability of the insurer but also affect the insurance market as a whole. They often induce price wars which more responsible companies are sometimes forced to follow.[47] Such practices may also prevent the building-up of sufficient reserves and thus threaten the medium- to long-term solvency of the companies involved.

64. In Argentina, low retentions and high commissions have resulted in some insurers acting like brokers. A large number of companies were retaining very little on loss-making lines of businesses and ceding the bulk of their portfolio to the state reinsurance monopoly, Instituto Nacional de Reaseguros (INdeR).[48] This eventually led to the collapse of INdeR, which ceased operations on 31 March 1992, and to the disappearance of more than half of the existing insurers.

65. In Chile, fierce competition leading to a cut-throat price war over market shares has resulted in operating losses for a number of companies. However, underwriting losses have been offset by good returns on the stock market.[49]

High acquisition costs

66. In several developing countries it was considered that acquisition costs were too high.

67. In Pakistan, it has been argued that agency commissions should be limited to 10 per cent.[50]

68. In Tunisia, the allowed commission for agents soliciting motor insurance cannot exceed 8 per cent for passenger vehicles and 9 per cent for other motor land vehicles. Insurance companies are not allowed to pay more than 5 per cent of their net premium to agents as commission.[51]

69. In Turkey, the Government fixed at 30 per cent the maximum commission on agents' registration fees and sharpened qualification criteria for agents.[52]

Statistical database

70. Insurance is based on the theory of probability and the law of averages. A sound statistical base is vital for the operation of an insurance company and this key aspect has not been given sufficient

importance in a number of developing countries. In several countries, efforts have been undertaken to collect statistics through insurers' associations, but the situation has been far from satisfactory.

71. The insurers' associations of Malaysia, Singapore and the Philippines are trying to maintain a database of motor statistics compiled from data from their respective members. They have found, however, that some companies do not submit replies whilst in other cases the replies are so poorly completed that the statistics "are useless."[53] In some cases efforts have been made to integrate the collection of statistics with the routine work of document preparation. Instead of preparing separate statements for statistics, the latter are picked up directly by the computer operator from copies of the original documents.

Problems in the area of claims

72. One of the causes for the poor image of the insurance industry is a general dissatisfaction with claims settlement. The expeditious and fair settlement of claims is one of the most important competitive tools available to insurers, since the consumer's judgement of the quality of services rendered is primarily based on the insurer's ability to handle claims efficiently. In addition, delays in settlement of claims may increase the ultimate liability of insurers, due, inter alia, to the inflationary factor.

73. There are many reasons for delays in settlements. They may be caused by the insurer himself, due to a lack of expertise or insufficient claims staff, or may be due to a lack of cooperation from public agencies (e.g. police, fire department, etc.,) in providing corroborative evidence. The judiciary is often overburdened. Lack of expertise, low remuneration and an insufficient number of claims surveyors and loss assessors is another important factor. Ignorance and often illiteracy on the part of the client, coupled with failure to fully document claims, further complicate the situation.

74. Delays in settlement may cause hardships. In many developing countries interest is not paid on the claim amount for the period of delay. It may, however, be noted that in some countries courts have started awarding interest payments for delayed remuneration on the claim amount.

75. Administrative inefficiency and lack of co-operation from public agencies are often the cause of delays in the settlement of claims. Delays may also be due to cash flow problems or, in more serious cases, solvency problems in the company.

76. In Colombia, the new law of December 1990 stipulates, inter alia, "that claims must be paid or be objected to in "a serious and reasonable manner" within one month, and this obligation is unaffected by any reinsurance contract."[54]

77. In the Philippines, "a new regulation is pending enactment which qualifies as a criminal act the failure or refusal of an insurance company to settle claims within the prescribed period."[55]

78. The establishment of an insurance ombudsman by the authorities is aimed at resolving conflicts of interest between insurers and recipients of claims or liability awards. Several examples follow.

79. In Malaysia, the Insurance Mediation Bureau (IMB) commenced operations in 1992. Its services are directed at the policyholder who has failed to obtain a "satisfactory response to his claim from the senior management of his insurer." The service is free of charge and the IMB is financed by the insurance industry.[56]

80. In the Philippines, the Insurance Commissioner has called for the appointment of an insurance claims ombudsman to give policyholders additional recourse against insurers if they are dissatisfied with their claims settlement.[57]

81. The General Insurance Association of Singapore will widen the terms of reference of the Insurance Ombudsman Committee (IOC) to include complaints concerning commercial insurance policies held by individuals. At present, the IOC intervenes only on claims problems with personal policies.[58]

82. In Trinidad and Tobago, it was reported that the establishment of an insurance ombudsman is under consideration. This proposal was favoured by 70 per cent of the general insurers, but objected to by 80 per cent of life insurers.[59]

Fraud and thefts

83. In Liberia, fraudulent fire claims have caused many insurers to withdraw from this line, while those remaining are now charging very high rates.[60]

84. In Rwanda, road transport is vulnerable to banditry.[61] To prevent and combat fraud and theft, insurers in some countries are setting up prevention schemes and statistical collections are made on both losses and fraud.

85. In Malaysia, an industry-wide database is currently being promoted by the Association of Insurers to curb the trend of rapidly deteriorating results, in part due to a growth in the number and size of fraudulent claims.[62]

Loss assessment and survey

86. Loss assessors and surveyors play a pivotal role in the settlement of claims. Their acts of omission and commission could be responsible for both delay and customer dissatisfaction. A significant level of professionalization of this cadre is essential for the growth of the insurance sector. While basic insurance training is available in a number of developing countries, in many countries training for loss assessors and surveyors is not available.

Judicial procedures

87. In many countries it can take a long time, often up to 10 years, for a legal process to be completed. Some countries have tried to cope with the situation by increasing the capacities of the courts, and by instituting systems of arbitration for pending cases of compensation to motor accident victims.

88. In India, the institution of informal arbitration proceedings called LOK ADALAT (People's Court) has made it possible to settle a large number of pending cases and to substantially reduce the time between the occurrence of an accident and payment of compensation. This period has been shortened to no more than two to three years. This scheme has been supported by the judiciary.

* * *

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Chapter II

INSURANCE REGULATION AND SUPERVISION

A. Role of supervisory authorities

89. Insurance companies are an important part of the financial system in developing countries. Therefore, it is necessary to ensure their stability so that public confidence in the institutional financial structure of the country is maintained. Supervisory authorities, as the executive arm of the Government, have an important role in ensuring that insurance companies function in an orderly manner.[1]

90. At the operational level, the primary responsibility of supervisory authorities is to protect the interest of the policyholders. Insurance is not only a commercial transaction but also has social aspects. Life insurance companies, for example, deal with long-term savings of individuals. In the non-life sector, it is necessary to ensure, as a matter of public policy, that policyholders and beneficiaries of liability policies (e.g. victims of road accidents) receive due compensation.

91. Supervisory authorities have a special role in respect to safeguarding the interests of consumers of products related to "mass risks". These consumers may not be in a position to evaluate the content of products and their pricing in the same manner as consumers of commercial covers. This problem is accentuated in developing countries by the fact that insurance awareness is low and information about "mass products" is often not sufficiently dispersed.

92. Another function of supervisory authorities in developing countries concerns the regulation and supervision of insurance companies as institutional investors and mobilizers of savings. Insurance companies have large funds at their disposal, arising from the policyholders' fund in life insurance and technical and free reserves in non-life insurance. Their prudent investment is relevant not only from the point of view of the policyholder but also from the aspect of developing the economy. In many countries these funds constitute an important part of the total national investment. Insolvency in this sector, therefore, would have an adverse effect on the economy as a whole.

B. Deregulation and liberalization

93. Apart from their traditional role of monitoring the solvency of insurance companies and their investment activities, supervisory authorities may have to ensure that the principles deriving from the processes of deregulation, liberalization and opening of markets, such as the rules of establishment, national treatment, non-discrimination and transparency, are respected. They may also have the responsibility of preventing breaches of rules of competition. One of the main concerns of many participants, from both developing and developed countries, in the group negotiations on services within the Uruguay Round was that Governments should be able to develop and maintain an effective and prudential regulatory system, whatever the commitments made towards liberalization.[2]

94. The Casablanca African Insurance Reassessment Workshop of October 1990 stated in this respect, inter alia, that "in the context of liberalization and privatization, independent, strong and competent control authorities are needed to ensure the protection of consumers and that the rules governing the proper functioning of markets are respected."

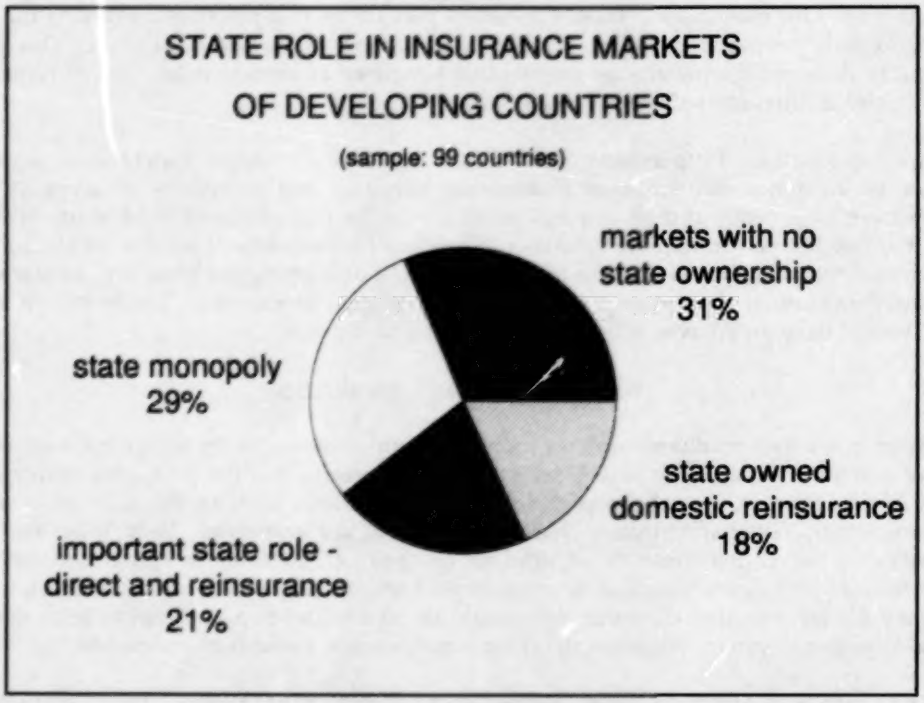
95. The 8th Third World Insurance Congress (TWIC) held at New Delhi in February 1992 recommended, inter alia, that "sweeping reforms wherever applied, including the insurance sector, can only be successfully implemented with the establishment of a strong and well-administered prudential regulatory system". The introduction of liberalization reforms and the opening of insurance markets may

face implementation difficulties if they are not accompanied by "prudent regulations" to be enforced by competent supervisory bodies. Otherwise, distortions and imbalances may appear. Such effective regulation and supervision should provide a stable environment for the development of a sound insurance market.

96. In Indonesia, in February 1992, new insurance legislation was passed. Under the new legislation, the Ministry of Finance is the supervisory authority and is empowered to set out requirements for licensing and revoke existing licenses, inspect a company's operational procedures, require financial and investment reports on a regular basis and request a public court to declare a company bankrupt. If an insurer is liquidated, under the new legislation the policyholders' rights have precedence over the general creditors. The increased regulatory powers are meant to enhance consumer confidence and, thereby, stimulate demand for insurance products.[3]

97. In Sri Lanka, new legislation is being prepared and should be enacted in advance of the privatization of the two state-owned insurers. The Insurance Control Act aims to protect policyholders' rights during and after the privatization process. High accounting standards will be set and regular auditors' reports will be mandatory. The Central Bank of Sri Lanka will act as the supervisory authority.[4]

Figure 1



Source: Statistical Survey on Insurance and Reinsurance in Developing Countries 1983-1990, UNCTAD, 1994.

98. The structure of the market in a country would have a bearing on the nature and extent of supervision. If insurance is the monopoly of the State, supervision through a regulatory organization will not be of the same type as in the case of a market where the insurance sector is entirely in private hands. In a number of countries the State is playing an important role, in both direct insurance and reinsurance, through public sector companies which operate side by side with private sector companies. In other countries the direct insurance operations are in the private sector, but the State could have an influence

on, or a measure of control of, the market through a state reinsurance company. Figure 1 gives an overview of state involvement in the insurance sector of developing countries.

C. Political backing for supervisory authorities

99. It is often pointed out that the mere existence of complex laws and regulations does not necessarily bring about effective supervision. Supervising authorities should be backed by political support and should have sufficient resources at their disposal. In some cases even very sophisticated supervision has failed to detect collapsing insurance companies. None the less, supervisory authorities play a prime role in managing crisis situations and preventing the insurance market as a whole being unduly shaken by the default of a few companies.

100. In Barbados, the Government has appointed an insurance supervisor, a post provided for but not filled since the inception of the new law in 1983. The move was welcomed by the industry. It is reported that Barbados wants to be pragmatic in meeting requirements to be competitive in respect of fiscal and infrastructural arrangements so as to preserve its good reputation as an international financial centre. It does not want to be seen as merely providing casual screening of applications, freedom from taxation or loose regulations and supervision.[5]

101. In Mexico, the new regulation meant to liberalize and open the country's industry has instituted a new regulatory body called the National Commission of Insurance and Bonds.[6] The establishment of this new body is seen as part of a move towards more vigorous and effective regulation of the industry and the overall supervisory framework is designed to provide less intrusive but more effective control.[7]

102. In Trinidad and Tobago, a technical team that reported to a special ministerial committee found that seven general insurers out of 28 failed to pass viability tests, confirming the view that the Insurance Supervisor's Department has been lax in enforcing the existing regulations in recent years.[8] To improve the effectiveness of the Insurance Act, it was concluded that there should be an increased monitoring of insurance companies' operations. The Government moved to put much tougher rules in place, including:

- A higher minimum paid-up capital for general insurers;
- The cancellation of a company's registration if it remains technically insolvent for more than 30 days;
- Proof at the end of each financial year that companies have genuine assets to back their liabilities;
- Introduction of stiffer operating tests relating to expenses and liquidity.[9]

103. In Uruguay, a special committee is discussing a draft law which is expected to lead to the ending of the state monopoly in insurance and is part of a package aimed at reducing state monopoly throughout the economy. The proposals include: the establishment of an Insurance Supervisory Authority which would deliver authorizations to both new and existing companies; regulations governing requirements for solvency, technical reserves, management, capital, legal domicile and placement of reinsurance.[10]

104. In the Republic of Korea, in April 1989, the Insurance Supervisory Board was established following the internationalization and deregulation of the insurance sector.[11]

105. In Sierra Leone, the Commissioner of Insurance reported that the lack of power of the Commissioner's office has led to a general lack of discipline at all levels of the business and stated that his office needs strengthening through increased personnel, responsibilities and statutory functions.

D. Tariffs and rate setting

106. Monitoring the solvency of insurance companies is one of the prime concerns of supervisors. In recent years, supervisory authorities in some countries have shifted from the practice of checking rates and tariffs to a more global approach of monitoring and formulating reserves and solvency requirements. In these countries, it is deemed that removing restrictions in rate setting would allow insurers with a competitive edge to give lower rates and more advantageous terms and conditions to customers.

107. This represents a shift from ex-ante to ex-post scrutiny, and has two implications for insurance companies in developing countries. First, due to a freer regime of rates and conditions of insurance, competition might depress profit margins. As a consequence, a higher capital base and a careful reserve policy would be required to stay in business in the long run. Secondly, greater responsibility would be placed on the management of insurance companies. Both of these trends can be discerned. On the one hand, capital and solvency requirements are being increased, and on the other greater attention is devoted to applying stricter criteria for determining the fitness of managers of insurance companies.

108. Nevertheless, a large number of countries continue to maintain a tariff system, with supervisory authorities standardizing terms and conditions of policies and their pricing. While a freer system of pricing and conditions may ultimately bring more opportunities to consumers, it presumes their ability to differentiate objectively between products offered. Such conditions, however, do not prevail in many markets. It has therefore been argued that the availability of a limited range of unsophisticated covers tailored to the more basic needs as regards insurance protection would be a suitable approach in many developing countries.

E. Capital and solvency requirements

109. The introduction of higher standards for capital and reserve requirements may have a positive impact on the retention of business written domestically. This in turn might have a positive influence in decreasing foreign exchange requirements for reinsurance.

110. In Brazil, a new accounting system, introduced in July 1989, requires a substantial increase in reserves. This will oblige companies to obtain additional assets to guarantee the increased reserves.[12]

111. In Chile, where the market was deregulated in the early 1980s, the reinsurance monopoly and tariffs have been abolished and the market has been opened to foreign capital. Consequently, the tasks of the supervisory authority were redefined. It now has to execute a strict follow-up on all matters related to an insurer's financial and economic stability. These include investment policies and compliance with minimum capital and solvency margins.[13]

112. In Colombia, the Law of 18 December 1990 has set new minimum capital requirements which might be revised annually in the first two months of each calendar year, although adjustments may not exceed the weighted average of the consumer price index. Requirements for technical reserves such as current risk reserves, mathematical reserves, reserves for outstanding losses, and reserves for loss ratio deviation, as well as their calculation, were also defined by the new law. On the other side, terms and conditions of policies no longer require prior approval by the authorities. They must, however, now be filed with the authorities, which might disallow badly worded policies or those quoting uncompetitive rates.[14]

113. In Ghana, a new law is to be promulgated which specifies the capital requirements for setting up an insurance company.[15]

114. In Kenya, the Insurance Act was put into force in 1987. Its aim is to curb the lack of discipline in the insurance industry and to protect policy holders. All companies have to comply with minimum capital and solvency requirements.[16] In 1989, the Insurance Commission deleted from the registration list two insurance companies and five brokers after having screened the solvency margins of insurers, brokers and agents.[17]

115. In Malaysia, Bank Negara, which has taken over the supervision of the insurance sector, is reviewing the financial solvency requirements of insurers which it feels have experienced some deterioration. The Bank is considering introducing solvency criteria based on a claims experience to complement the existing requirements to make insurers more selective in underwriting new risks. It is also considering the need for composite insurers to maintain separate solvency margins for each class of business.[18]

116. In Mexico, a new law which ends minimum tariff rules will increase price competition. At the same time insurers will also be required to meet tough new minimum capital requirements and new rules on solvency requirements modelled on European Community standards. Insurance companies will be free to market their policies without explicit official approval.[19]

117. In Namibia, the new insurance law requires the registration of insurers, brokers and reinsurers and sets minimum capital requirements, as well as deposits with the commissioner for each line of business.[20]

118. In Nigeria, a new decree is expected to increase tenfold the minimum paid-up capital for life and non-life operations in comparison with the previous amounts regulated under the 1976 Insurance Act.[21]

119. In Oman, a new regulation has been enacted by the Royal Decree No. 12/89, determining minimal capital requirements, deposits for each line of business and solvency margins.[22]

120. In Pakistan, where there is constant reviewing by the Government of compliance by insurance companies with the solvency criteria of the Insurance Act of 1938, cases are being prepared against seven insurers, of which three are leading companies; two have already had their licences cancelled and a similar fate awaits a third company.[23]

121. In the Philippines, on 17 March 1992, a new law was enacted that sets new minimum capital requirements for new joint ventures, new insurance and reinsurance companies.[24] It has been reported that the implementation of this new regulation has run into problems as many insurers see the tenfold increase in capital requirements difficult to follow. The Philippines Insurance Commission has suggested that insurers incapable of meeting the requirements may opt to have their underwriting activities restricted.[25]

122. In Senegal, a new set of laws is in preparation which will toughen the regulation on the solvency of companies and reinforce sanctions against fraud.[26]

123. In Singapore, new solvency margins are to be introduced in 1993. Solvency margins for general insurers will be increased fivefold.[27]

124. In Thailand, plans exist to set up an Insurance Stabilization Fund to handle insolvency cases, and a threefold raise in the minimum solvency margin has been proposed to the Parliament, with the margin to be increased in proportion to the volume of premiums written.[28]

125. In Tunisia, the Parliament has adopted a new insurance law to be enacted as of 1 January 1993. The new law augments the presentation of information of interest to the insured and lays down regulations concerning the financial security of the insurer.[29]

F. Investment regulations

126. Investments of insurance concerns must have the following three basic characteristics: they should be reasonably liquid, have a high standard of safety and provide a reasonable rate of return. Accordingly, in a number of countries, rules are stipulated for the investment of funds. In some countries the rules were formulated with the purpose of channelling investments into target development areas and sometimes to cover, in part, the government budget deficit. It has been argued that this might be in divergence with the interests of policyholders and, subsequently, the case for more liberal investment opportunities has been advocated. In certain countries a relaxation of investment requirements has taken place. However, amounts have often been prescribed for various categories in percentage terms of the total investment. A portion of available funds can be invested in the financial market at the discretion of the insurer for the purpose of maximizing his yield, but the basic criteria are nevertheless prescribed.

127. In Bangladesh, private sector companies have expressed concern that the 55 per cent corporate tax levied on their profits is impairing their performance and reducing funds for potential investment. It has been reported that they have proposed a reduction of the corporate tax to 30 per cent explaining that this would allow a generally more profitable investment of disposable income.[30]

128. In Colombia, the current law of March 1991 sets new requirements for investment policy regarding technical reserves, of which 40 per cent have to be placed in specified instruments.[31]

129. In Mexico, the rules governing the investment of technical reserves have been liberalized. They now allow free investment of 70 per cent, while only 30 per cent must be invested in ways specified by the Government (mainly state bonds). The 70 per cent "free" investments may be placed in some 30 authorized securities, including secured loans, positively yielding real estate and Petro bonds.[32]

130. In Nigeria, according to regulation that took effect in 1993, registered insurers are obliged to invest in property development a minimum of 20 per cent of their non-life funds and 40 per cent of their life funds. Further, at least half of these investments are to be made through the Federal Mortgage Bank of Nigeria at an interest rate of 4 per cent at the time of reporting.[33]

131. In Senegal, a new law under preparation will propose a new approach towards investment in the light of the need for the insurance sector to play a stronger role in the economic development of the country.[34]

132. In Singapore, new investment regulations are to be introduced as of 1993, fixing maximum limits on investment placed in any one category and for investment in a related company, and a minimum level of liquidity in assets will be required.[35]

133. In Thailand, insurance companies received permission in 1989 to diversify investments into property development.[36]

134. In Turkey, the Government is considering regulations which would encourage insurers to increase their investments in the local capital markets. A government study recommends that insurers be required to invest at least 25 per cent of funds collected in the Istanbul Stock Exchange.[37]

G. Reporting and information requirements

135. The most important "tool" at the disposition of supervisory bodies is the timely receipt of information from insurance companies and its early analysis and assessment. The process of reporting to the supervisory authorities might also be a beneficial exercise for the management of the insurance company, as it may provide an opportunity for introspective analysis. Uniform reporting would also enable comparisons to be made with other insurers in the same economic environment. It has been suggested that, when checking reports, the supervisory authority should watch for certain signs.[38] These may be:

- A decrease in operating margins while the market share increases;
- An escalation of expenses without a measurable increase in business volume;
- The occurrence of an operating loss for two or more successive years;
- Major business shifts undertaken by large intermediaries;
- A consistent lack of underwriting profits;
- A high staff turnover; and
- A noticeable variation in outstanding claims provisions.

136. At the Casablanca African Insurance Reassessment Workshop of 1990, the areas of competence of supervisory authorities were defined as follows:

- The control of the activities of all the players in the insurance sector, and the verification of the honourability and competence of insurance managers;
- The control of the books of accounts, in particular technical reserves, and capital and solvency margins;
- The on-the-spot control of insurance companies through the right to investigate on their premises;
- Acting as the privileged collector of information for the Government; and
- Building up an information base on the security of insurance and reinsurance companies and brokers.

137. It was reported that it was difficult for supervisors to ascertain the true state of affairs from a mere examination of returns. It was therefore recommended that, to be able to assess the reality of the situation and to understand the operational aspects, the supervisory authorities should keep in constant touch with the industry and have periodic meetings with its representatives. Spot inspections of the books and records of companies are regarded as an essential aspect of monitoring.

138. In Brazil, since 1 July 1989, insurance companies must comply with a new Chart of Accounts which follows United States standards.[39]

139. In Chile, each insurer, reinsurer and broker is under the control of the Supervisory Authority, where information on their performance can be obtained.[40]

140. In Papua New Guinea, amendments to the Insurance Act require that when seeking exemption from localization rules in order to place risks internationally, applications must provide full details of arrangements sought. If the Commissioner deems it necessary, premium receipts, cover notes, policies and other documentation may be requested for presentation.[41]

141. In Malaysia, Bank Negara, the authority which is supervising insurance, together with the Association of Certified Public Accountants, has finalized guidelines to set uniform accounting standards and a formal format for presenting the financial statements of life and non-life companies. The aim of this new format is to "ensure that the accounts reflect the true financial position of an insurer and provide a sufficient amount of disclosure." It will promote better information on their performance and enhance the effectiveness of the supervision of the insurance industry.[42]

H. Human resources

142. To be able to fulfil their role effectively, supervisory authorities need qualified staff. At the Seminar on Human Resources Development in the Field of Insurance, held at Lisbon in 1990[43], the training and education of staff in insurance supervisory authorities of developing countries was identified as an area of priority action. In the opening paper given at the 1992 TWIC conference, it was emphasized that there was still a gap between the insurance industry and the supervisory authorities in terms of the level of knowledge of the business. It was, however, the responsibility of supervisors to gain information and knowledge comparable to what is available in the industry.[44] Further, it has been argued that "if supervisory personnel was highly qualified both personally and professionally, it would usefully fill gaps in the legislation and become, especially in developing countries, one of the main instruments available to the State for promoting the national development of financial intermediaries."[45]

143. However, supervisory authorities in many developing countries encounter problems in attracting and retaining skilled personnel. It has therefore been suggested that careful attention be devoted to career prospects for personnel. Schemes such as "binding training programmes", which have been implemented in Singapore and Malaysia, may provide a solution. Under such schemes training is paid by the Government on condition that the trainee serves in the department for a minimum period or reimburses the training expenses.

I. Dynamic role of supervisory authorities

144. Supervisors should have a dynamic approach and go beyond merely checking compliance with the law. They should extend their role to identifying the problems faced by the industry and assist in finding solutions. This would help them to be perceived as beneficial and positive by the industry. By virtue of closeness to the legislators, they might also be instrumental in improving the legislative framework. The active role played by the supervisory authority in Morocco might have helped the industry to improve its performance. The growth rate of its total premium ranked as the third highest worldwide during the period 1987-1989 and it was the only African country in the top 10.[46] Amongst the measures adopted by the Moroccan supervisory authorities, mention may be made of the following:

- Revision and updating of insurance legislation;
- Privatization of two insurance and reinsurance companies;
- Fixing minimum capital requirements and exerting influence for a capital increase in other cases;
- Requiring companies to submit and comply with a "re-organisation plan" in well-defined situations;

- Creating a "solidarity fund" to provide financial assistance to companies whose position has been weakened due to the fact that they are engaged in one or several categories of compulsory insurance whose premium rates are fixed by legislation;
- Warning, reprimanding and suspending managers who do not observe regulations;
- Working out a new scale of compensation for motor accident victims;
- Modifying the procedures to be followed for motor accident compensation claims;
- Revising motor insurance premium rates;
- Introducing premium collection norms;
- Easing taxation on life insurance, marine insurance and savings and capitalization transactions.[47]

J. Auxiliary services

145. Supervisory authorities are beginning to take an interest in "auxiliary services" such as those provided by reinsurance brokers, agents, and loss assessors and surveyors. In some countries attempts are also being made to reduce acquisition costs, if considered excessive, and the commissions of brokers and agents and other intermediaries are under scrutiny.

146. In Indonesia, under new regulations brought into force on 26 February 1993, brokers will be held liable for claims arising if premiums received are not passed on to the insurer before the payment deadline. Further, brokers are no longer allowed to issue cover notes as they can only be issued directly by insurers. The new regulations encompass rules for brokers, agents, loss adjusters and actuaries.[48]

147. In the Islamic Republic of Iran, new regulations concerning insurance agents were put into effect on 23 October 1992. The new rules permit both legal and natural entities to act as agents and require an annual tax statement to be presented on renewal of the agency licence.[49]

148. In Kenya, the Commissioner has been looking at the solvency margins of insurers, brokers and agents, and has deleted the registration of two insurance companies and five brokers.[50]

149. In Namibia, a new insurance law requires the registration of insurers, brokers and reinsurers. Brokers have to purchase a fidelity guarantee bond to pay a deposit and purchase a professional liability insurance.[51]

150. In Singapore, strict minimum requirements have been proposed for general insurance agents and brokers to improve the general standard of service through better product knowledge and proficiency, while observing a professional code of conduct when transacting business. Further, the General Insurance Association of Singapore is preparing to register all adjusters, appraisers and surveyors that are contracting with its members.[52]

151. In Tunisia, the commission allowed for agents soliciting mandatory motor business may not exceed 8 per cent for passenger vehicles and 9 per cent for other vehicles.[53]

152. In Turkey, to overcome the problem of bad premium collection, the Government has, besides other measures, fixed a maximum of 30 per cent for commissions, doubled the agents' registration fee and sharpened qualifications criteria for agents.[54]

153. In the United Arab Emirates, effective from 24 April 1992, the insurance law was amended to better regulate the operations of local insurance brokers and agents. The amendment requires brokers on registration to declare all insurers whom they will be representing, to show a bank guarantee and to take out a professional indemnity insurance. Overseas brokers must be, in addition, registered in their country of origin for more than five years and must have generated a minimum specified amount of business.[55]

* * *

Notes

1. A separate UNCTAD document "Issues of insurance regulation and supervision relevant for developing countries" (UNCTAD/SDD/INS/6) deals with the particular issues of insurance regulation and supervision in respect to economic development.

2. "GATT Activities - 1990", GATT/1991-2.

3. Asia Insurance Review, May-June 1992, p. 10; World Insurance Report, No. 441, 17 July 1992, p. 7.

4. World Insurance Report, No. 460, 23 April 1993, p. 7.

5. Ibid., No. 353, 6 January 1989, p. 8.

6. Insurance Research Letter, February 1990.

7. World Insurance Report, No. 382, 2 March 1990, p. 1.

8. Ibid., No. 380, 2 February 1990, p. 6.

9. Ibid., No. 386, 27 April 1990, p. 9.

10. Ibid., No. 401, 23 November 1990, p. 5.

11. Ministry of Finance, Republic of Korea.

12. Insurance Research Letter, September 1989.

13. Best's Review, December 1990; Insurance Research Letter, April 1989.

14. Insurance Research Letter, June 1991.

15. World Insurance Report, No. 369, 18 August 1989, p. 3.

16. Insurance Research Letter, March 1989.

17. World Insurance Report, No. 355, 3 February 1989, p. 6.

18. Insurance Research Letter, July 1991.

19. World Insurance Report, No. 382, 2 March 1990, p. 1.

20. Insurance Research Letter, January 1991.

21. Ibid., September 1990.

22. International Research Services, April 1992.

23. Best's Review, February 1989, p. 77.

24. Insurance Commissioner of the Philippines, Manila, Philippines, 3 April 1992.

25. World Insurance Report, No. 459, 9 April 1993, p. 7.

26. Ministry of Economy and Finance, Dakar, Senegal, April 1991.

27. World Insurance Report, No. 422, 11 October 1991, p. 6.

28. Asia Insurance Review, March-April 1991, p. 27.

29. L'Argus, 1 May 1992, p. 29.

30. World Insurance Report, No. 460, 23 April 1993, p. 8.

31. Insurance Research Letter, June 1991.

32. Ibid., February 1990; ibid., May 1990.

33. World Insurance Report, No. 466, 16 July 1993, p. 11.

34. Ministry of Economy and Finance, Dakar, Senegal, April 1991.

35. World Insurance Report, No. 422, 11 October 1991, p. 6.

36. Ibid., No. 387, 11 May 1990, p. 4.

37. Ibid., No. 428, 17 January 1992, p. 4.

38. Shaw, R. L., "Insurance supervision and the changing economic environment", paper presented at the AIO Conference, Nairobi, May 1992.

39. Insurance Research Letter, September 1989.

40. Ibid., April 1989.

41. World Insurance Report, No. 428, 17 January 1992, p. 8.

42. Insurance Research Letter, July 1991.

43. See endnote 30. from Chapter I, para. 34.

44. Mony, S. V., "The role of supervisory authorities", paper presented at the 8th TWIC, New Delhi, April 1992.

45. Outreville, Jean-François, "The regulation and supervision of financial services including insurance", unpublished paper, Geneva, 1990.

46. SIGMA, Swiss Re, No. 4, 1990.

47. Chahdi, Hassan Quazzani, "The role of the State and of supervisory authorities in the developing of insurance: The case of Morocco", paper presented at the African Insurance Reassessment Workshop, Casablanca, 8-11 October 1990.

48. Asia Insurance Review, May-June 1993, p. 14.

49. World Insurance Report, No. 457, 12 March 1993, p. 6.

50. Ibid., No. 355, 3 February 1989, p. 6.

51. Insurance Research Letter, January 1991.

52. Asia Insurance Review, January-February 1991, p. 47; ibid., May-June 1992, p. 12.

53. Report by the Permanent Mission of Tunisia to the United Nations, Geneva, 4 June 1991.

54. World Insurance Report, No. 424, 8 November 1991, pp. 4-5.

55. Ibid., No. 441, 17 July 1992, p. 7.

Chapter III

LIFE INSURANCE

A. Introduction

154. Life insurance constitutes a significant segment of the world's insurance business. Table 2 shows the distribution of world premium between life and non-life. It constituted 52 per cent of total premium income in 1989 and overtook non-life insurance.

Table 2
Total world premium

Category	1985 per cent of total	1989 per cent of total
Non-life	55	48
Life	45	52
Total	100	100
Total US$	630.5 billion	1,210.0 billion

Source: Reinsurance Market Report, 14 July 1992, p. 11.

155. The volume of life insurance business transacted in developing countries is low. Table 3 shows their market share of world life insurance premiums.

Table 3
Market share of world life insurance premiums

	1988	1990
	per cent	
Developing countries	3.68	4.79
Africa	0.10	0.08
Asia	3.29	4.39
Latin America	0.29	0.32
Developed countries (a selected number)		
United States	28.71	29.09
Japan	34.76	28.74
EC	20.68	24.79

Source: SIGMA, Zurich, Swiss Re, 4/1990 and 4/1992.

156. The share of life in the total insurance sector of developing countries differs widely. The statistical survey of 91 developing countries prepared by UNCTAD, which refers to the situation in developing countries between 1984 and 1986, shows that in 11 countries there was no life insurance sector, and in 54 countries the share of the life sector was between 0.1 per cent and 30 per cent (see table 4).

Table 4
Share of life business in total insurance business
in developing countries, 1984-1986

Share of life business in total insurance business (per cent)	Countries surveyed	
	number	per cent of total
0	11	12
0.1 to 30	54	59
30 to 50	17	19
more than 50	9	10
	91	100

157. Life insurance is not merely a commercial activity, but has several other important aspects. It provides financial security to the insured individual and his or her dependants. Social security systems are either non-existent or insufficient in many developing countries. While this problem cannot be solved easily, life insurance contributes positively to its resolution.

158. In many countries, savings instruments are not sufficiently developed and life insurance could provide a viable answer. Three characteristics of life insurance make it an apt method of saving. First, saving is on a regular and controlled basis, rather than sporadic and dependent upon a surplus being left after consumption. This makes it particularly suitable for developing countries where the pressure to spend available income is generally higher because of lower standards of living. Second, the savings element is closely linked with the motivation to provide security to family members. Thirdly, life insurance is easy to understand and its operation from the point of view of the individual is simple, unlike many other methods of saving. It accommodates well middle and lower-income groups who are uninitiated in the intricacies of sophisticated personal investment instruments and it is a method for individuals to save for old age.

159. From a macroeconomic viewpoint, life insurance is a mechanism for mobilizing the savings of individuals for long-term investment. The life insurance sector is thus an important financial institution in developing countries and could play a major role in the development of capital markets. It is often one of the biggest investors in real estate.

B. Factors governing life insurance

160. The potential for growth of life business in developing countries remains high. A number of economic and social factors determine the level of supply and demand for life insurance and influence the growth of registered business. A study by the UNCTAD secretariat on the promotion of life insurance in developing countries noted that "the growth of life insurance business is inextricably interwoven with economic development. Economic development usually brings about increased personal savings".[1]

161. In the absence of a defined and uniform system of statistics to show incomes of individuals, growth in GDP is taken to represent the basic parameter of demand for life insurance. The growth of life insurance can be measured in terms of insurance density and insurance penetration. Insurance density is defined as a country's premium income per capita. The penetration of insurance is defined as the amount of premium income as a percentage of GDP. An analysis of various markets indicates that countries with a high GDP per capita tend to have a high insurance penetration and insurance density. Life insurance density and penetration depend also on the public social security schemes in force as well as on the existence of capital markets and investment possibilities. Table 5 gives the density of insurance and the penetration of insurance of a few developing countries in Africa, Asia and Latin America. For

reference, the indices for some developed and some Eastern European countries in transition are also given.

Table 5
Life insurance penetration and density: 1990

Country	Penetration*	Density**	Country	Penetration	Density
Africa:			Asia:		
Zimbabwe	3.34	20.84	Rep. of Korea	9.45	523.35
Kenya	0.48	1.58	Singapore	1.80	239.12
Morocco	0.34	3.93	Malaysia	1.37	32.68
Côte d'Ivoire	0.19	1.90	Philippines	1.19	7.38
Egypt	0.16	1.26	India	1.11	3.73
Cameroon	0.14	1.97	Thailand	0.97	13.72
Tunisia	0.13	2.04	Pakistan	0.44	1.53
Nigeria	0.12	0.28	Indonesia	0.23	1.34
Algeria	0.03	0.41	China	0.18	0.53
Libyan Arab Jamahiriya	0.01	1.11	Islamic Rep. of Iran	0.03	3.08
Latin America:			Developed countries:		
Chile	1.77	33.80	Japan	6.42	1,645.45
Panama	1.22	24.93	United Kingdom	6.24	1,145.63
Mexico	0.42	11.06	United States	3.79	823.12
Dominican Rep.	0.40	3.25	France	3.09	692.44
Uruguay	0.39	7.72	Canada	2.77	601.74
Colombia	0.32	3.48	Germany	2.21	563.03
Brazil	0.18	2.13	Italy	0.66	132.93
Venezuela	0.11	2.48			
Argentina	0.09	2.89			
Some countries in transition:					
USSR (1990)	1.57	67.21			
Czechoslovakia	0.98	17.92			
Hungary	0.44	13.99			
Romania	0.35	3.65			
Poland	0.08	1.42			

Source: SIGMA, Swiss Re, 4/1992.
* Premium income as percentage of GDP.
** Premium in US$ per capita.

Growth in income and its distribution

162. Apart from the fact that individual incomes may increase as a result of economic growth, their distribution throughout various segments of the population is also important for the life sector. Life insurance business is likely to benefit most when the middle-income group has income growth higher than the high- and low-income groups. While no clear-cut model or comparative statistical analysis of this aspect has been made, the insurance sector might keep this in view while planning its strategies.

Financial markets and fiscal concessions

163. For the life sector to grow, financial markets must be constituted in a manner which is conducive to savings. Increased confidence in life insurance as a savings instrument would be generated if opportunities existed to compare and judge a variety of instruments. For a proper comparison of returns on other types of savings with those on life insurance, due account has to be taken of the tax advantages, both for the payment of premium and for the receipt of maturity.

164. Life insurance is often regarded as safer in comparison with other instruments because its funds are invested to provide stable long-term growth rather than large short-term gains. This presumes that life insurance companies remain financially sound for the duration of issued policies.

165. Still, the investments of a life insurance company are often shorter in term than its liabilities. This presents a problem if yields oscillate and the security of obligations to policyholders is in doubt. The investment term to policy maturity mismatch can be a significant source of instability for a life insurer. An increase in short-term interest rates or a rapidly expanding equity market can deflect savings away from the life sector. Conversely, a drop in investment earnings may make it hard for insurers to make good their obligations to policyholders.[2] If life yields are not competitive with other savings instrument, the potential consumer may prefer to buy only term life insurance.

166. In countries where life insurance is considered as a competitive alternative savings instrument, it represents a substantial part of the overall business and the life sector premiums embrace a significant portion of private savings. Examples of such countries are the Republic of Korea or Singapore.[3] In Malaysia, the Director General of Insurance parallels the unrealized growth potential of life insurance with the low ratio of premiums to private savings. This ratio was on average 5.7 per cent for the period 1980-1991 and was significantly lower than the ratio of new deposits in banks and financial companies to private savings of 27.1 per cent.[4]

Life insurance and taxation

167. The subject of tax policy and life insurance in developing countries was considered in detail by a study undertaken by the UNCTAD secretariat in 1985.[5] Various aspects and approaches to the taxation of a life insurance company and to tax benefits for policyholders and beneficiaries, both in respect of premium paid and benefits received, were examined in detail. It emerged that "the tax policy adopted by Governments towards life insurance can have an important influence on the extent to which life insurance is successfully integrated into the society" (para. 3). At the same time, it is understandable that taxation on the life insurance sector "must be moulded" together with the country's economic policy (para. 4). It "cannot be designed in isolation from the structure of the existing tax system" (para. 25). As far as taxation of the insurance company is concerned, account has to be taken of the fact that "premiums and reserves are calculated on assumed future experience", and that "the actual experience and profits will emerge only after many years" (para. 22). As regards tax or fiscal concessions for policyholders for the premiums paid and for beneficiaries on the proceeds of the policy, account has to be taken of incentives available through other savings instruments. It was pointed out that each Government must decide "whether it should adopt a position of economic neutrality among the various savings institutions" (para. 33) so that the tax policy of the country is not the "cause of one product, service, or type of provider having an economic advantage over another in the market place". (para. 32)

168. The policyholder may face a threefold tax issue. Tax obligations may be imposed during the actual purchase of a policy. The position of the authorities on whether premiums paid should be deductible from the assessable income of the policyholder's tax obligation is yet another factor influencing the development of the sector. Further, the question of taxation of benefits accruing from a policy should be addressed through relevant legislation.

169. In this connection, it is reported that Thailand has introduced new tax concessions allowing policyholders to double tax deductions on life premiums.[6] In Morocco tax advantages have been provided for life insurance to increase its attractiveness. The Law on Finance of 1989 has reduced the tax burden on policyholders from 6 to one per cent on purchase of policy. The preservation of this tax is sometimes questioned as it does not generate meaningful income for the State. Conversely, it presents a psychological barrier to the entrance of new policyholders. Premiums paid can be deducted from the annual income tax obligation but only up to a specified limit according to the Law on Finance.[7] It has been reported that a major reason inhibiting the development of life business in French-speaking Africa is the lack of tax advantages for individuals on premium paid and the imposition of a tax on premiums received by a life insurer. In Benin, tax incentives are being reviewed in order to make life insurance more accessible to families with lower incomes.[8]

170. In Singapore, the taxation of the life sector has changed significantly as of 1993. Life insurance companies are now taxed on a "total profit" basis. Income now includes both premiums and investment income while expenses include benefit payments and increases in actuarial reserves along with management expenses and commissions. Surplus accruing to policyholders will then be taxed at 10 per cent while shareholders' surplus will be taxed at a higher rate of 30 per cent.[9]

Life insurance and inflation

171. The rate of inflation has several serious implications for life insurance. From the company's point of view, it upsets its calculations, particularly those related to remedial costs associated with managing long-tail claims arising from disability or sickness.[10] For the insured the real value of the savings element of the policy is eroded. Since high rates of inflation are witnessed in a number of developing countries, life insurance companies have to be attentive to the situation and prepare for the changes that may be necessary in their strategies, particularly concerning products offered and their marketing. Since the actual rate of inflation that will take place is unpredictable, it is the expectations in the minds of potential clients that really matter.

172. Persistent inflation would have the following implications. Policies where the savings portion is periodically returned while the risk portion is kept up for the duration of the contract would normally be preferred by clients. A "three-stage policy" where a good portion of the savings accumulated are returned to the insured at three stages has proved to be popular in Pakistan.[11] Those who require risk protection are likely to opt for long-term policies which have a very low savings element. Since these policies are low premium policies, the overall premium income of the company may decline if inflation is expected in the future.

173. New products may have to be devised. A flexible system, under which the sum insured is increased from time to time so that the real, i.e. deflated, value of the cover is maintained, has been suggested. The premium would also be revised under this system. Those who do not want the revision can stay with the old premium and sum insured.[12] The indexation of life insurance policies has not been explored sufficiently because of a variety of practical difficulties, one of them being whether the index used is perceived as reliable by the public.[13] It is also possible to hedge against inflation by issuing policies in a hard currency or linking them with the price of gold, or substituting the payments on maturity of the policy with commodities or real estate.

174. The inflationary environment in Jamaica is shifting consumer interest away from traditional and towards interest-sensitive and equity-linked products. Policies that are denominated and pay benefits in hard currency are under consideration. There is concern in the local business that allowing such policies would encourage overseas competition through local brokers.[14]

175. In Zimbabwe, the Life Offices Association reports that, despite the current economic reforms, the life sector has not achieved the expected performance. Persistent low incomes and high inflation have created uncertainties in the minds of potential policyholders and led to terminations of policies by existing clients.[15]

The social environment and life insurance

176. The level of literacy and education influences the life insurance market. Those who are not exposed to modern economic knowledge may tend to prefer "sterile" forms of savings such as jewellery or gold. Ideological, cultural or religious reasons may impede the development of life insurance. "Fatalism, local customs and traditions, reliance on help from the family ... and even religious beliefs"... may... "prevent people from providing for their family in case of death or even their own old age."[16] Further, the extent to which life insurance can be successfully promoted depends on the stage of development of a country's infrastructure, its social security system, its legal system and the consumption habits of the population.

177. In North African Arab countries life insurance is sometimes considered inappropriate on religious grounds and non-life insurance still represents the bulk of the market.[17] In Mauritania, religious reasons are, inter alia, responsible for a low level of life insurance, which accounts for only 0.36 per cent of the total insurance business. Still, life insurance has been fixed as a development objective by the country's insurer SMAR.[18]

178. In the Islamic Republic of Iran, the Islamic contract of Mozarbeh is employed, which means the elimination of interest in accordance with Islamic principles. The contract postulates that someone will entrust his savings to another person who will use them for a commercial venture with the profits being divided as agreed at the outset.[19]

179. In Indonesia, a low per capita income and religious views have been cited as the two most restrictive factors to the growth of life insurance. The insurer faces substantial difficulties in conveying the benefits of a cover to customers as it is an "intangible" product. Only when claims arise does the value of insurance become apparent. Therefore, professionalism in claims handling is of primary importance to building insurance awareness.[20]

AIDS

180. The emergence of AIDS is a matter of great concern to life insurance companies, particularly in developing countries. According to the World Health Organization's (WHO) figures of 31 December 1993, so far there have been 851,628 reported cases of AIDS. WHO estimates that the total number of AIDS cases worldwide is around 3 million. The number of HIV cumulative adult infections is much larger, and is estimated to be around 15 million. Of this the geographical spread is approximately as follows: 9 million in sub-Saharan Africa, 2 million in South and South-East Asia, 1.5 million in Latin America and the Caribbean, 1 million in North America and 0.5 million in Western Europe.[21] WHO estimates that by the year 2000 there will be 30-40 million HIV-infected persons.[22]

181. For life insurance, AIDS poses two problems. The first and immediate problem is the increase in mortality of persons already holding some kind of life policy, since claims will have to be honoured in case of AIDS-related deaths. The second problem concerns the treatment of AIDS in future policies to be issued and raises questions of an ethical nature concerning the positions of the insurer, the insured and society in general. It has been argued that it is inappropriate in the long run to take AIDS-related deaths as an increase in mortality, as this raises the question of equity between insured individuals.

182. AIDS undermines the adequacy of rates developed from current mortality tables. In Africa, principally the central, eastern and southern parts, and parts of the Caribbean, AIDS-related deaths are expected to raise adult mortality rates by over 100 per cent. The infected individuals' mortality would be very high. For example, an infected 35 year old male can be expected to live 10 or 11 years. Of all infected persons, 45 per cent have developed symptoms after 9 years. It is likely that 7-8 years may pass between infection and symptoms, and during this period the individual has a full work capacity.[23] The impact of AIDS on population growth is expected to be minimal, while a strong effect is expected on the mortality rates.[24]

183. The Caribbean is said to have the highest per capita number of AIDS cases in the world, and the resulting losses in the life business will inevitably have to be compensated from general insurance activities. In Barbados a US$4 million fund has been formed by a mutual life insurance company to meet anticipated AIDS-related death claims, in expectation of a significantly higher mortality rate. Barbados life insurers have started mandatory testing of applicants for life cover over B$200,000. In Guyana insurers have started to insert exclusion clauses into all life policies, which relieve them of any obligation to claims if the insured dies of AIDS-related sickness.[25]

184. In Zimbabwe claims arising from declared AIDS-related deaths seem to be only a small portion of the total true AIDS claims. AIDS-related claims are in reality much higher, since for many persons who die of AIDS-related sicknesses and for whom claims are paid out, this fact is not put on their death certificates. When the mortality tables currently in use were constructed, AIDS was totally unknown and not taken into account. This has resulted in large unexpected payments being made by life insurers for both life and disability products. Due to under-reporting and an inadequate statistical base, it is difficult to estimate the extent to which AIDS is affecting life portfolios. Nevertheless, the Life Offices Association suggests that a significant portion of premature policy defaults have been induced by AIDS deaths, thereby contributing to performance below expectations for the life insurance sector. As a result, group life covers can be twice as expensive now in comparison to early 1992.[26]

185. When applying for life insurance, the testing methods and information sought from applicants are often seen as violating the privacy and rights of the individual. The need to categorize the applicant in a risk group, in order to administer a proper cover and demand a premium viable for the workings of an insurer, raises questions of discrimination. The issue of discrimination and privacy conflicts with the principle that low-risk individuals should not be subsidizing the premiums of high-risk individuals. Evading the occurrence of subsidization means taking into account two considerations of equity: equity among policyholders and the assignment of adequate premiums for corresponding risks, and equity in society as regards insurers. Insurers cannot be expected to bear a burden disproportionate to their responsibilities; this burden should be shared on an equitable basis with the rest of society.[27] The problems connected with AIDS are so grave in many countries that they have to be resolved by society as a whole, which should give insurers clear general guidelines for their specific policies in the life insurance field.

186. The need for risk evaluation of those applying for insurance is well recognized but in the context of AIDS is a sensitive issue. Any information obtained should be utilized with due care and respect for the privacy of the individual. It should not influence the client's social and economic position. The confidentiality of the medical report is of prime importance, because people will present themselves for testing only if they believe that no unauthorized disclosure will follow.[28]

187. Apart from adapting their workings to the new situation caused by AIDS, insurers should play an active role in its prevention through co-operation with all relevant medical and government authorities. Since insurers reach a large number of people in their everyday activities, they can make a productive contribution to awareness-building and education.

188. Antiselection is a significant problem. Individuals seeking insurance who have tested HIV positive or who belong to a high-risk group substantiate this problem. It has been found that the average life policy of an AIDS victim at the time of death has been in force for a significantly shorter period than policies of persons not infected by AIDS. Further, the average AIDS claim is higher than a non-AIDS claim. It is believed that group insurance is generally less subject to antiselection than personal insurance.[29]

189. In Zimbabwe the following measures are being considered in order to lessen the effect of AIDS on life portfolios:

(a) Increasing the group and basic individual life rate;

(b) Setting up an AIDS contingency fund;

(c) Moving more towards the marketing of investment contracts like pure endowments and reducing the period of cover on life and endowment policies;

(d) Enforcing HIV testing for sums insured at $100,000 and above for individual life policies and $300,000 for group life;

(e) Remodelling life contracts in such a way that proposers have to go for HIV testing (e.g. making the minimum term policy equal to $100,000);

(f) Improving the training of life underwriters so that they maintain a strict but fair and consistent approach towards underwriting high-risk HIV cases by exercising extreme caution when accepting applicants who fall into any of the high risk categories.[30]

190. In Thailand, increasing numbers of AIDS victims have prompted the Thai Life Insurance Association to consider imposing additional conditions on policyholders. Compulsory blood tests and exclusion of liability for a certain time period have been suggested. Presently, blood tests are required only for policies with an insured sum exceeding Bt3 million. Applicants who test HIV positive are not issued policies.[31]

C. Constitution of the life insurance sector

191. Life insurance is a long-term business. Laws and regulations in many countries stipulate that the surplus arising from better investment earnings, improvements in mortality and lower expenses than presumed in premium calculation, cannot be taken by the company as its own profit and has to be shared substantially with policyholders. Only a small part of the surplus may be kept by the company. Consequently, a substantial benefit to shareholders from the growth of the business takes time to manifest itself. Similarly, because of the availability of a large investment portfolio and a good cash flow associated with this line of business, downturns also take time to become visible.

192. By the same token, a larger capital base is required to manage a life insurance company successfully than a non-life insurance company. A concentrated market is therefore conducive to the growth of life insurance. The requirement of a large capital base is in fact one reason why foreign insurance companies, with the backing of the large capital and resources of their corporate office, have been allowed to operate in a number of developing countries. This is also a major reason why a number of developing countries have constituted parastatal institutions for the life insurance sector.

193. Competition in the life insurance business in developing countries often includes life insurance companies of developed countries which are neither established nor authorized to operate locally. These

insurers have a competitive advantage from the relative strength and stability of developed countries' currencies. In spite of foreign currency restrictions that may exist in developing countries, foreign-currency-denominated life insurance policies are often bought by their residents. This problem occurs particularly in countries that have a history of high inflation and devaluations of their national currency.[32]

194. In Indonesia, drastic action will be taken against agents operating without valid licences. The primary purpose of such measures is the protection of policyholders from possible claims disputes with foreign operators. Under the laws enacted in February 1992, the undeclared agent may face a jail sentence up to 15 years and a maximum fine of US$ 1.2 million.[33]

195. Supervisory authorities in many developing countries are endeavouring to improve the capitalization of life insurance companies in their country. This could be achieved by encouraging mergers and acquisitions and by gradually increasing minimum capital requirements and enhancing standards of valuation of policy reserves and solvency margins. The policy of not issuing new licences for life business to avoid the proliferation in the market of a large number of small companies has also been common in many countries.

196. On the other hand, the life insurance market in the Republic of Korea is opening up. In the three years preceding October 1990, 14 new domestic companies were licensed.[34] In Pakistan the Government has adopted a policy of deregulation and liberalization. A limited number of companies will be allowed in the life sector but not as composite companies, i.e. transacting both life and general lines. The private sector opines that the capital base requirements set out are excessive and protective of the public sector. Even so, private insurers have been applying for permission to start working life insurance lines and are reported to see a good perspective for their business.[35] Two companies have been granted licences and at least five more are awaiting a decision on their applications.[36]

197. The Bank of the Netherlands Antilles will consider changing its policy of not awarding new licences to life insurers in response to their improved performance during the past three to four years. Past policy aimed to shelter the weak financial position and results of the life sector.[37]

198. Another development, again arising from the need for substantial resources to develop a life insurance account successfully, is the entry of banks and other financial institutions in the insurance business. As both life insurance companies and financial institutions deal with savings and investment, there is a synergy between their operations. So far this has happened mostly in developed economies, but the trend can be expected to have repercussions in developing countries.

199. It has been reported that in Malaysia selling life insurance over bank counters is already gaining popularity. The competition from financial institutions offering protection and savings products is on the increase, as distribution through the banking networks is significantly less costly than through the traditional agency force. The savings can be passed on to the clients in the form of cheaper premiums.[38]

200. The Insurance Agents Association of Israel has been critical of banks that provide mortgage and at the same time sell life policies to the borrower in order to insure repayment of the mortgage. Often such policies are sold without using qualified insurance agents or requesting obligatory medical examinations. The widowed spouse may then end up owing the mortgage because insurers would not award compensation for a policy that has not been issued in accordance with prescribed conditions.[39] On the other hand, it has been reported that insurers are entering the mortgage loan business and are, in cooperation with certain banks, becoming increasingly active in the financial market. The cooperation between banks and insurers has developed in order to utilize the banks' marketing capacities as they operate a large number of branch offices.[40]

201. In the Republic of Korea, so-called "quasi-life" insurance has been increasing its market share in the life sector. "Quasi-life" denotes policies handled by the Post Office, the National Agricultural Co-operative Federation, the National Federation of Fisheries Co-operatives and the National Credit Union Federation. While the insurance products offered by these organizations are similar to those offered by mainstream life insurers, these "quasi-life" products offer higher returns because of the lower business expenses of the issuing organizations. In a potential disadvantage to the insurance consumer, such "quasi-life" insurers do not come under the strict scrutiny of the Insurance Business Law.[41]

202. The life insurance sector in the Philippines is experiencing increased competition from non-insurance firms. Such firms are not subject to a rigorous supervision by the authorities and thus present possible drawbacks for their policyholders.[42]

Product development

203. Life insurers may consider adopting a "marketing" rather than a "sell what you have" approach.[43] Products have to be constantly reviewed and "tailored" to meet the changing and varying needs of consumers. Improved access to information has brought about a revolution in consumer aspirations, often making product diversification a necessity. Products offered should "not only provide the important ingredient of risk cover but also incorporate a certain amount of flexibility, liquidity and offer returns which have some relevance and bearing to the rate of return available through other financial instruments."[44]

204. It is reported that in Turkey life insurance is becoming an important alternative to savings, and new products, such as foreign-currency-denominated policies, are being introduced.[45] In Singapore the life sector is considerably market-oriented and offers policies for very specific needs, such as "childrens' education" or "serious illness" policies. Innovations including living assurance (receiving benefits from a life cover should a specified disease occur), permanent health insurance, vanishing premium plan, (under which the policyholder stops payment of premium in a relatively short period, and the accrued bonus is used to finance further premium payments) and bond policy (a one-time premium payment purchases a number of bond units; the returns pay for a growing amount of life cover). In an increasingly competitive environment, research and development are becoming important in satisfying customer demand. The dynamic approach adopted by Singapore companies helped improve coverage by life insurance from about 21 per cent of the population in 1986 to about 42 per cent in 1991.[46]

D. Areas of concern for life companies

205. The areas to which the management of life insurance companies has to give particular attention can be summarized as: investment management competence, actuarial skills, cooperation with the Government, distribution systems, linkages with other institutions, mortality statistics, the allocation of surplus and penetration into the rural sector.[47] These and other related issues are discussed in general terms as follows.

Investment management

206. As trustees of savings of policyholders, life insurance companies have substantial funds for investment. The aim is to maximize the yield on these investments and minimize risk taking. To assure that life insurance companies keep a well balanced investment portfolio, governments often prescribe parameters for the investment of life funds. Accessible and diverse investment opportunities do not exist in many countries and investments that will be safe and yet give a reasonable yield are not available. For example, it has been reported that in Senegal the main factor hindering a stronger development of life insurance is the insufficient investment opportunities for funds. The return on bank deposits is small and inadequate to stimulate growth of the life sector.[48]

207. A great deal of investment skill and imaginativeness is required, particularly since a long-term strategy has to be adopted. Many insurance companies in developing countries have not paid sufficient attention to developing investment expertise and often manage their investments through the accounts department or by utilizing the services of investment trusts.[49]

Actuaries

208. The services of actuaries are indispensable in life insurance. They are required for assessing the implications of changing maturity rates, estimating trends in investment earnings and expenses incurred, interpreting the effects of changing market conditions, of product development and price setting, and most importantly for calculating the surplus that results from operations, or "valuation", and determining the solvency margin. These tasks cannot be achieved by accounting practices.

209. However, an actuarial qualification is difficult and time-consuming to acquire and developing countries generally suffer from a lack of experienced actuaries. Often actuarial services have to be obtained from abroad and this requires foreign currency. Smaller and medium-size companies may have no choice but to engage an actuary on a consulting basis. The life insurance sector should consider training its personnel up to middle-level actuarial knowledge, so that at least some of the routine and simple work can be done within the companies themselves. Certified courses could be arranged for this purpose and actuarial training could be offered by regional and national insurance institutes.

210. From January 1994 onwards, life insurers in Singapore must have an Appointed Actuary. The Appointed Actuary will have a wider range of activities than before. He will be asked to recommend prudent investment strategies and assess capital requirements for business growth. In addition, he will be requested to address areas of possible financial vulnerability of the company, alert the management accordingly, recommend corrective measures and report to the Commissioner on their implementation. The actuary will be appointed by the insurer subject to the Insurance Commissioner's approval. Such an enhanced role of actuaries is already operational in the United Kingdom and Canada.[50]

Cooperation with the Government

211. Governments and supervisory authorities play a prominent role in the conduct of life business as they set standards for the valuation of the life fund and the determination of the surplus and its distribution. Since life insurance represents the savings of individuals which have to be kept invested, guidelines for the investment of funds are often stipulated. Furthermore, in many developing countries a substantial part of investments must be made in government securities or bonds on the grounds that this safeguards the policyholders' savings. Life insurance is also greatly affected by fiscal policy as both policyholder and insurer are subject to taxation. Good cooperation with the authorities would benefit the life sector.

Distribution system

212. Unlike many lines of non-life insurance which are purchased to comply with the requirement of a credit institution or a law (third party motor insurance), life insurance has to be "sold". Marketing can be done either by company staff or by agents compensated through commission. It is reported that in francophone Africa it is mostly company staff who realize sales.[51] In most other developing countries agents are responsible for selling life insurance. In the Asean countries, 95 per cent of individual life policies are sold through agents.[52]

213. In many developing countries the essential problem with agents is that the qualifications of the people who take up this profession are generally poor. Most work part time and the insurers' turnovers of agents are high. It has often been stated that keeping the turnover rate under control is the biggest

challenge for a company's management.[53] Most agents produce a low volume of business, and only a few contribute a reasonable amount. In general, a well placed human resources development strategy is needed for the selection, training, motivation and supervision of the intermediaries of life insurance.

214. The recruitment of agents is often left to the sales managers. An alternative could be to have full-time salaried recruiters. The advantages of this approach would be that such professionals would have a more specialized knowledge relevant to their task. The sales managers would then be able to spend more time on training, supervision and team building. Further, recruiters would be in a position to follow company rules and guidelines on recruitment more strictly. However, this approach also has its drawbacks. Agents recruited in this fashion may not be matched as well to the prevailing corporate culture which is better personified by the sales manager than by a professional recruiter, and higher costs may be incurred.[54]

215. "High pressure" selling is unproductive in the long run.[55] This factor alone is to a great extent responsible for the poor image of the life sector. The complaint is often made that the agent is interested primarily in booking the business and earning the commission, and does not provide after-sales service. Sales that are not based on genuine needs also lead to a subsequent high lapse ratio or, conversely, to a poor conservation ratio. Life insurance is a very personalized business[56] and the delivery agent has to be well versed in financial and fiscal matters. He should be able to give proper advice to the prospective policyholder about taxation aspects and various other alternative savings instruments with which the life sector is competing, and should be able to help in analysing the various options from a long-term point of view. The agent is often responsible for collection of the premium. He should also provide effective after-sales services such as helping the client in completing formalities, e.g. for obtaining a loan on the cash value of the policy, and in processing claims.

216. Recognizing the important role played by agents, the authorities in Singapore have issued minimum industry standards for their recruitment, training and management. The regulations cover minimum age, education and qualifications, and promotions. They also redefine commission scales and measures to prevent misrepresentation of the benefits of policies.[57]

217. In an endeavour at self-regulation, in Malaysia the Life Insurance Association (LIAM) formulated two sets of guidelines to enhance professionalism in the sector, which were implemented as from 1 January 1991. The Guidelines on Pinching and Movement of Agents were devised to regulate the movement of agents from one company to another in order to protect the interests of policyholders rather than to restrict agents. The Guidelines on Registration of Corporation Bodies as life insurance agents were instituted to standardize the procedure of appointing companies selling life insurance products. The registration requirements include a paid-up capital amount, with a grace period of up to three years for implementation, and a restriction of holding an agency contract with only one principal. The agents themselves have to pass a Pre-Contract Examination and be authorized by LIAM. LIAM has also drafted set procedures for different types of claims and has listed the necessary documentation along with the time requirements for processing.[58]

218. An important aspect in the marketing of life insurance is that strict control of costs has to be maintained. This is necessary to keep up the attractiveness of life insurance as a savings medium in comparison with other savings and investment instruments. In view of the weaknesses of the institution of agents as discussed above, this is not an easy task for a company to achieve on its own, since it operates in a competitive environment. The Association of Life Insurance Companies in Malaysia has done useful work in working out methods of controlling acquisition costs at the industry level.

Linkage with other institutions

219. Opportunities also exist for insurers to establish a link with mutual funds, credit card organizations and institutions that provide housing mortgage loans.[59] Pension-type retirement plans for employees of corporate bodies on a group basis have also been devised in many countries.

220. It has been observed that opportunities offered for various low-income groups have not been sufficiently explored. A standardized product can be marketed by establishing a linkage with other agencies. Such a product may not require the personalized services of an intermediary, allowing costs to be reduced. Considerable work has been done in India in arranging low-cost insurance for salaried employees on a group basis.

Sharing of surplus

221. The allocation of surplus as determined by valuation is an important issue. In many countries statutes or regulations require that a substantial part of the surplus, as much as 75 to 95 per cent, has to go back to policyholders. There are several methods of sharing the surplus with policyholders. In cases of with-profit policies, a cash bonus could be paid from year to year, or at designated intervals. In some countries, in particular in India, the bonus is distributed at the time of death or maturity. For without-profit policies, premiums are revised in line with the current experience.

Penetration of life insurance into low-income and rural sectors

222. The vast rural sector remains insufficiently explored. Reasons often advanced for this are that the sector is characterized by low income levels, high illiteracy rates and a wide geographical spread, making it difficult to deliver the traditional and standard product.

223. However, a group approach linked to a suitable agency, such as a mutual or a cooperative, a trade union, distributors of inputs such as seeds or fertilizer, or those who purchase rural produce for processing, could be considered. Social and welfare organizations can help in constituting a group of clients. Amounts of cover can be kept low, and the policy benefits limited, covering primarily the risk factor.

224. Concerning the payment of annual premium, which often causes a problem because of the clients' fluctuating incomes, a certain degree of flexibility may be considered. When a reasonably large group is involved, pre-acceptance medical examinations may be dispensed with. Non-medical insurance, whenever attempted, has shown good results. The premium tables could be established for tranches of age, say on a quinquennial basis. In the absence of birth certificates, a simple process of certification by a recognized but easily approachable authority may be stipulated. A simplification of administrative requirements would be helpful in cutting costs and reaching a broader range of middle and lower-income customers.

225. The life business in India will increase its efforts to promote insurance in the largely uninsured rural areas. At present, more than 45 per cent of new policyholders come from the rural sector.[60]

226. In Pakistan, efforts have been made to promote life insurance in rural areas through newspapers, radio and television. The share of rural business in the total business was almost 43 per cent in 1990.[61] Group life insurance represented 16.4 per cent of the total life premiums in 1990 and covers about 15 per cent of the labour force. Group life insurance is compulsory for all working people.[62]

227. In China, life insurance is not limited to industrial and urban areas. The growth of written premium in rural areas has often matched and at times surpassed urban growth. With almost 80 per cent

of the population living in rural areas, the potential for expansion of life insurance is great.[63] Today, 200 million people are insured and nearly 70 types of covers are available.[64]

Mortality tables

228. An issue connected with improving life insurance products in developing countries is the need to develop mortality tables. Specific information is not available about countries that have developed their own mortality tables. Many developing countries utilize, with some modification, mortality tables compiled abroad. While this is understandable in initial stages, it should be possible to gradually build mortality tables, if necessary on a regional basis, by sharing data. This would help to establish a more realistic and credible premium structure.

229. Such mortality tables based on experience for 1961 to 1964, 1970 to 1973 and 1975 to 1979 have been constructed in India. Mortality tables have also been constructed for Singapore, Malaysia, and Thailand for 1977-1983, under the auspices of the Commissioners of Insurance of ASEAN countries. A second set of mortality tables for the five-year period ending in December 1988 will be available in the near future.[65] In Mexico, the National Commission on Insurance and Bonds, in cooperation with the College of Actuaries and the insurance sector, has developed a new mortality table encompassing the most recent statistical experience for the years 1982-1989. This table is obligatory for the calculation of the mathematical reserves and replaces the previous table dated 1962-1967. A separate Group Mortality Table is to be used for group life policies and social benefits.[66]

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Chapter IV

MOTOR INSURANCE

A. Introduction

230. Motor insurance is an important branch of insurance in many developing countries. On average it brings in more than one third of all non-life premiums.[1] It is also a sensitive class of business since it is compulsory in many countries and therefore affects and concerns a considerable portion of the population, particularly in urban areas.

B. Importance of motor insurance

231. Motor insurance is particularly important to the insurer because it represents a major source of cash. Motor insurance premium income is steady, with no specific periodic or seasonal variations. It allows insurers to meet their normal obligations and provides opportunities for the investment of funds on a long-term basis. Another important feature of motor insurance is that it requires less reinsurance than other lines. The amount at risk per vehicle is small and the spread is good. Reinsurance is required primarily for third party liability and is usually taken on an excess of loss basis. The limits are comparatively moderate and hence the cost of reinsurance is reasonable. Therefore a major part of the premiums generated can be retained. This is not normally the case in other lines of insurance where substantial reinsurance may be required.[2]

C. Performance of motor insurance

232. A number of countries are confronting unfavourable underwriting results in their motor sectors. The rise in the rate of accidents has generally surpassed the growth rate of the number of vehicles. Furthermore, the increase in accidents has been coupled with an augmentation in the severity of losses.

233. The causes for the growing number of accidents are numerous. They can be attributed to greater traffic density, particularly in urban areas, bad road conditions, inadequate traffic control, poor vehicle condition, insufficient maintenance, and inexperienced and sometimes careless driving. It has been reported that more than 230,000 people are killed every year in road accidents in developing countries and that accident rates in many countries are rising by more than 10 per cent a year. Similarly, it has been observed that for example in Bangkok, Thailand, 52 per cent of cars surveyed drove through red traffic lights and in Sarabaya, Indonesia, less than one per cent of drivers surveyed stopped at pedestrian crossings. According to a recent inspection in New Delhi, India, nine out of ten buses had rear, brake or side lights out of order.[3]

234. Vehicles engaged in public transport in developing countries are very often overloaded and poorly maintained. Improved road conditions and high powered buses and trucks may encourage speeding and increase the probability of accidents happening. Other factors affecting loss ratios include insufficient first aid and ambulance facilities, rising levels of court awards and mounting costs of auto repairs. More effective implementation of loss prevention practices involves relatively low costs and may offer significant potential for improvements in loss ratios, particularly when there are difficulties in modifying tariffs.

235. Reports from some countries in respect of motor insurance results are given below.

236. While motor insurance in Chile has experienced steady growth since the inception of a new law in 1986, the loss ratio has climbed to 75 per cent. When acquisition and management costs are added to the loss ratio, the motor line shows a negative underwriting result.[4]

237. In Côte d'Ivoire, motor insurance takes up 45 per cent of the insurance market and has a loss ratio of 144 per cent.[5]

238. In Egypt, the net loss ratio for compulsory cover in the motor sector has varied between 166 and 325 per cent for the years 1986/87-1990/91.[6]

239. In India, for some categories of vehicles, loss ratios have climbed to 500 per cent.[7]

240. In the Republic of Korea, underwriting results in the motor sector are the worst of all branches with loss ratios of 70.2 per cent and 65.9 per cent for the years 1988 and 1989 respectively.[8]

241. In Israel, the motor sector experienced an underwriting loss for compulsory insurance of NIS 66.2 million in 1990.[9] In 1991, of the total NIS 250 million loss experienced by the insurance sector, motor vehicle insurance contributed with a loss of NIS 170 million.[10] The insurance industry fears that the situation might get worse if the Supreme Court does not reverse a decision by a district court of May 1993 which states that drivers who cause an accident can claim indirect damages for the loss of value of the vehicle in a future sale. If insurers become liable for first party indirect damage they will probably apply for an increase in premium rates.[11]

242. In Malaysia, with the combined motor claims ratio rising to an estimated 125 per cent in 1989, results are rapidly deteriorating.[12]

243. In Mauritania, the loss ratio climbed up to 130 per cent in 1991. In part, the problem lies with the motor tariff which was fixed in 1980 and has not been revised since.[13]

244. It was reported that in Trinidad and Tobago, practically no company underwriting motor business would make money in 1989.[14]

245. In Zimbabwe, several insurers have experienced underwriting deficits, and the loss ratios for buses have been exceptionally high.[15]

D. Inadequacy of tariffs and risk classification

246. Motor insurance rates are generally subject to a prescribed tariff. Despite adverse claims experience, rates are often not revised for long periods, or are revised inadequately. There are several reasons for this. First, motor insurance rates affect a large cross-section of the population and therefore the issue is sensitive. Secondly, since the third party portion of motor insurance is compulsory and the level of compensation is a matter of public policy, the Government's direct or tacit consent has to be obtained when revising motor tariffs. Finally, insurance companies have often not been able to put up a good case for a revision.

247. A low level of motor insurance rates and a rating system that does not take the risk characteristics sufficiently into account, may provide wrong signals to owners and drivers. There is little incentive for properly maintaining a vehicle, driving it safely and adopting loss prevention measures. Often, rating structures are not based on the characteristics of the owner or the driver, such as age, occupation and accident record, but on the characteristics of the vehicle. Even the vehicle itself, its use, condition or age, is often not taken into consideration, or insufficiently so, for the establishment of motor rates. The rates are usually based on very broad classifications, for example according to estimated value and horse

power. In general, the client has considerable freedom in determining the amount for which his vehicle is insured. There is, however, evidence that as markets attain more maturity and sophistication, insurance products become more generic and incentives and penalties get put into rating patterns.

248. In Chile, new rates were introduced in April 1992 in view of recent accident experience. Premiums will both increase and decrease according to the established accident patterns. The cover has been changed and the deductible is now calculated according to the commercial value of the vehicle, rather than on the insured amount.[16]

249. In Congo, the central problem is an old tariff which was introduced in 1962 and which had only one minor adjustment in 1984.[17] In Côte d'Ivoire the tariff for compulsory motor insurance has not been revised since 1979.[18]

250. In Egypt, the approval of a law limiting the liability of insurers for compulsory vehicle insurance is expected soon. The law will limit compensation for accidents resulting in death or permanent injury to E£15,000. Reflecting on recent heavy losses, insurers are welcoming this change while, at the same time, criticism has been voiced that compensation payments have been set too low.[19]

251. A bonus-malus system and deductibles have been introduced in India.[20]

252. In Israel, cumulative rebates on premiums for claim-free years have been reintroduced. These benefits were abolished in the mid-1980s due to increasing motor losses. The present rebate is limited to 7.5 per cent following the first claim-free year and can go up to 30 per cent after four years.[21]

253. In Kenya, the Association of Kenya Insurers (AKI) has recommended an increase of rates for motor policies of 200 per cent as from July 1993. This has been accompanied by a strong protest from the Association of Insurance Brokers of Kenya, fearing a decline in business, and by measures by the Insurance Commissioner preventing the rate rise in apprehension of widespread dissatisfaction.[22]

254. In Malaysia, in order to render the motor business viable, the insurance authorities have concentrated on "a viable motor rating plan". A better motor rating plan would take into account characteristics of vehicles and drivers when setting premium rates.[23]

255. In Senegal, the market is unprofitable, as the auto tariff has been frozen for the past five years.[24]

256. In Sri Lanka, in December 1989 the motor insurance tariff was increased for the first time in nearly 20 years. The third party policy was increased by 233 per cent.[25] More recently, the Presidential Commission on Banking and Finance, in its fifth interim report, recommended a more frequent review of the state regulated motor tariffs.[26]

257. In Tunisia, suggestions have been made to dynamize the tariff system by introducing variable elements that will permit adjustments on the base tariff. It is recognized that the present system of uniformity, which imposes the same tariff for different risks, needs to be differentiated.[27]

258. In Turkey, the motor business was burdened in the past with a fixed low tariff generating inadequate premiums.[28]

259. In the United Arab Emirates, the Emirates Insurance Association has proposed the introduction of minimum and maximum rates for motor insurance. Premiums would fluctuate according to the claims experience of the driver and the type of vehicle covered.[29] Nevertheless, fierce competition has led to a reduction in rates and an increase in losses in the sector. The past three years, up to and including 1992,

have been described as the worst in history. As a result, several insurers have decided to increase motor premiums by 20 to 30 per cent.[30]

260. As of 28 January 1993, the Ministry of Economy of the United Arab Emirates abolished the universal and fixed deductible on the obligatory standard unified motor policy. Deductibles will now vary depending on the value of the vehicle or its purpose.[31]

261. In Zambia, where for a number of years a rigid tariff system had been in force, the motor business succeeded in presenting a convincing case to the authorities and managed to obtain adjustments in rates in 1979, 1982, 1983 and 1985. On these occasions opportunities were taken to introduce several new ideas to reflect the hazards involved. As a result, the motor account, which had traditionally been in deficit, turned around and showed a profit. The newly introduced concepts include:

- Physical inspection before commencement of insurance; requirement of an engineer's report for vehicles more than five years old;
- Introduction of the "average" clause, which reduces the claim amount in line with the proportion which the sum insured bears to the market value of the vehicle;
- Introduction of deductibles;
- Imposition of "area loading", varying from 12.5 per cent to 20 per cent depending upon the zone in which the vehicle normally moves, the capital city having the highest loading;
- Discounts if more than one vehicle is insured, if the person also drives a company vehicle, if the person accepts the restriction that the spouse will not drive, if anti-theft devices are fitted, and if the person is more than 40 years of age and has not been involved in any accident for four years;
- Introduction on a voluntary basis of a built-in personal accident cover and limited medical expenses if injury is sustained by the insured.[32]

262. The Casablanca African Insurance Reassessment Workshop of 1990 specifically recommended that, regarding the classes of business where tariffs are established by agreement of the authorities, the latter should take account of economic criteria.

E. Claims

263. The management of claims is affected by numerous and diverse problems.

264. Personnel: Many insurers attempt to improve their claims processing systems in order to control claims costs and provide better service to their clients. This is usually done through improving the skills and performance of their personnel. In motor insurance, most claims are assessed by independent surveyors, with only a few companies having their own in-house trained surveyors. Because these surveyors are not tied to any one insurer, delays and lack of commitment are often seen. Insurers may consider setting up screening and training programmes for surveyors while still respecting the latters' independence. This would be to their mutual advantage and would also benefit insurance consumers.

265. Repairs and spare parts: In many developing countries the insured parties utilize makeshift repair shops to have their vehicles repaired. The advantage of such shops is that they charge less than the officially approved garages and carry out repairs more quickly. The disadvantage is that the charges, although lower, are not standardized and a considerable amount of bargaining takes place. As a result,

it is often difficult for the insurer to ascertain the actual amount the client has paid for the repair. Original manufacturers' spare parts are comparatively expensive in many developing countries and non-genuine parts are frequently used. These are likely to be of inferior quality and the price may vary substantially. Often, even old and worn parts are used for repairs, making vehicles accident prone. The variable cost and quality of repairs and spare parts introduce an arbitrary element that complicates both a correct assessment of the claim and the appropriate establishment of the indemnity. Such conditions are not conducive to professional underwriting.

266. In view of the problems expressed above, the General Insurance Association of Singapore is to register all adjusters, appraisers, surveyors and motor workshops.[33]

267. Compensation for bodily injury: The settlement of claims for compensation of bodily injury due to road accidents has many problem areas. Accident rates in developing countries are high and a large number of claims have to be processed. Reports from the police often take a long time and are sometimes not sufficiently clear. The judicial process is slow. Hospitalization costs have been increasing and there are few standard norms regarding the level of compensation. In consequence the amount of compensation often differs from one region of a country to another.

268. Social implications: As pointed out, insurance companies frequently make a loss in their motor departments because of inadequate rates. It follows that when a claim is made they fight hard to avoid payment or at least to reduce the quantum. This has a public policy aspect since, although the cost of repairing the vehicle concerns only the owner, the compensation to the victims of road accidents affects the general public. The fact that a large number of victims are persons from low income groups further aggravates the problem. The authorities in developing countries should allow insurers at least an adjustment in the third party section of the premium rate so that the level of compensation is fair. This would also relieve insurers of the need to persistently and perpetually contest and challenge awards to accident victims. The legal process of determining compensation also deserves examination by the public authorities. Another problem is that in many developing countries the families of victims killed in car accidents do not present claims for compensation, taking the accident as a matter of fate. Severe hardship for the stricken families may be the consequence.

269. Theft and fraud: Satisfactory solutions to the insurance problems caused by theft and fraud require greater cooperation among the insurers themselves and between the insurers and their clients, the police department, the surveyors and the service and repair shops. Reports regarding several countries follow.

270. In Argentina, a group of insurers have formed a data sharing system to exchange information on stolen cars. In 1990, insurers paid out more than US$ 200 million in car theft claims.[34]

271. In Chile, as of April 1992 policy conditions have been changed. A compensation ceiling for additional coverage of theft of accessories has been fixed and accessories that are not permanently secured to the vehicle are excluded from the cover.[35]

272. In Colombia, the relatively high level of auto insurance is due primarily to two factors. First, third party cover is obligatory, and this provision is being strictly enforced. Secondly, an ever increasing number of motorists are today taking out comprehensive cover in view of the car-theft rate, which the police have been unable to reduce. Nevertheless, auto theft continues to be a major problem for insurance firms. It is estimated that at least 11,000 vehicles are stolen annually in the country, some 3,000 of them covered by theft insurance.[36]

273. In Kenya, the Association of Kenya Insurers (AKI) reports that car thefts have been escalating and that at least 10 vehicles are stolen every day. In 1992 2,834 vehicles were stolen while the projection for

1993 is 3,500 vehicles. At the same time, the recovery rate in 1993 has fallen to 15.3 per cent. In order to combat this situation, from January 1993 onwards AKI members are requiring drivers to have anti-theft devices installed before writing theft cover.[37]

274. To curb the trend of rapidly deteriorating results in Malaysia, in part due to a growth in the number and size of fraudulent claims, it is considered necessary to develop an industry-wide database. This idea is currently being promoted by the Association of Insurers.[38] The Road and Transport Department has proposed that the Government take over third party motor insurance as insurers are not resolving their problems of premium collection and fraudulent cover notes.[39] The current suggestion is to utilize the Road and Transport Department as a premium collection centre and to establish a single company which would provide solely obligatory third party liability motor covers. Meantime, action will be taken against the insurers and agents that write this business on the condition that the insured additionally purchases some type of non-motor insurance. In March 1993, the supervisory authorities, together with the Malaysian Insurance Association, have put into effect a set of rules to deal with this problem and the public is being encouraged to report any abuses.[40]

275. In Pakistan, certain insurers have stopped writing comprehensive insurance for cars because of the rise in car thefts. Representatives of insurance companies say that stolen vehicles often appear on the open market while owners are filing claims.[41] The theft of motor vehicles continues to increase, with claims for 1990 reaching more than 6,500 cases.[42]

276. In Trinidad and Tobago, the sharp rise in thefts is making motor insurance a distinctively unattractive business. The Insurers' Association hopes that a data bank will assist them in keeping down the incidence of theft claims suspected of being fraudulent. Multiple claims for the same vehicle are being experienced by many motor insurers, but the Association of Insurers does not have the centralized tracking system to gather the necessary evidence.[43]

F. Underwriting practices

277. Cash flow underwriting, the inability to control acquisition costs, cut-throat price wars for market shares and high inflation further deepen the disequilibrium between premiums and claims. In some countries measures have been introduced to ameliorate the situation.

278. In Brazil, companies are making efforts to improve productivity and risk selection, as they need to generate profits from underwriting and not from investments.[44]

279. In Peru, new regulations stipulate that rates are to be based on the technical principles of equity and sufficiency and on statistical information.[45]

280. In the Republic of Korea, the motor sector grew by 50.5 per cent from 1989 to 1990, largely due to the increase in the number of vehicles and the introduction of a malus/bonus system.[46]

281. In Singapore, the General Insurance Association has barred three of its members from granting discounts of over 50 per cent to vehicle owners with no claims bonuses in order to maintain the transferability of no claims bonuses.[47]

282. In Trinidad and Tobago, with companies writing business at low rates (due to fierce competition), inflation is bound to affect their ability to pay.[48]

283. In Zimbabwe, a 10 per cent discount is being offered to third party property damage policyholders if they are prepared to have their car insurance cover restricted to two drivers. Further, if a vehicle is

insured for comprehensive benefits over a specified amount then the policyholder will be offered a "loss of use" cover for a flat premium rate.[49]

G. Inflation

284. In Argentina, during the recent periods of hyperinflation, the value of an insured property could not be adjusted because there were no indexes that could predict price increases. For example, in the motor insurance branch, in 1989 policies were invoiced every four months, and a car's replacement value dating a month back could not be used a month later as a reference to estimate its total loss, since that value would have been less than 50 per cent of a similar car's actual price tag and premiums were of course hopelessly insufficient.[50]

285. In Brazil, the differences between government indexation and the variation of effective costs has an impact on the company's cash flow, affecting mostly motor insurance.[51]

H. No-fault schemes and guarantee funds

286. In a number of developing countries the introduction of a partial or full "no-fault" system is seen as a remedy for the deficiencies of their system of settling third party claims. It is deemed that such a system would provide for quick indemnification, without debating the question of fault. This is a departure from the traditional tort liability system, where the burden of proof lies with the victim. In certain countries indemnification schemes for victims of traffic accidents have been introduced, thereby speeding up settlements and making them more equitable, although somewhat limiting the compensation. Several reported developments follow.

287. In Chile, a law enacted in 1986 provides for two different types of insurance:

(a) A bodily injury insurance, where victims only have to declare that they were party to a traffic accident and name the insurance companies covering the parties to the accident in order to receive compensation. The compensation limits were set to enable companies to keep rates at reasonable levels.

(b) Regarding material damage, a third party coverage with the need of proof through judicial procedure was introduced. The new scheme is operating with acceptable levels of viability (64 per cent loss ratio).[52]

288. In India, the General Insurance Corporation (GIC) has taken over the administration of the Solatium Fund Scheme from the Ministry of Surface Transport. The Fund provides compensation to victims of hit-and-run road accidents where the vehicle cannot be identified.[53]

289. The Gulf Cooperation Council (whose members are Saudi Arabia, Kuwait, Bahrain, United Arab Emirates, Qatar and Oman) has recommended the setting up of a guarantee fund for no-fault motor accident claims.[54]

290. The Casablanca African Insurance Reassessment Workshop of 1990 recommended that:

- Limits to liability should be introduced, and "no-fault" systems considered;
- The establishment of guarantee funds for motor insurance should be studied.

I. Baremisation

291. In many African countries a "barème" scale for liability insurance in the motor business has been or is about to be introduced. It is to be used in court when awarding damages to victims of accidents or in direct payments to victims where no-fault systems have been adopted as is the case in Cameroon.[55] The purpose of the "barème" scale is twofold. First, it ensures that the victim gets adequate and speedy compensation. Secondly, it limits excessive and varying court awards. The following countries have adopted or are due to adopt such a "barème": Algeria, Benin, Cameroon, Côte d'Ivoire, Mauritania, Morocco, Niger, Rwanda, Senegal, and Togo.

J. Simplification of policy wording

292. Several countries have taken steps to simplify policy wordings so that policies can be understood more easily by the general public. These measures are expected to improve the image and credibility of the insurance sector and increase insurance awareness.

293. In Chile, claim consciousness is still very low. Only one third of traffic accident victims have put through a claim for compensation.[56]

294. In Malaysia, insurers are contemplating introducing policies with simplified wording so as to make them understandable to everyone.

295. In Peru, the new regulation mentions that terms and conditions of policies should be written in language best understood by the insured.[57]

K. Compulsory insurance

296. The trend of making third party motor insurance compulsory has continued. Obligatory third party liability for bodily injury from motor vehicles has in recent years been introduced or is under consideration in the following countries: Puerto Rico, Uruguay, Mozambique, Togo and Turkey.

297. In Argentina, compulsory motor insurance has been put in force as of February 1993.[58]

298. In the Belize, criticism has been raised concerning delays in claims payments and high rates for compulsory third party liability motor insurance. In order to ameliorate the situation government rate setting was introduced in 1988.[59]

299. In China, since 31 May 1989 all vehicles owned by foreigners must be covered with third party auto liability insurance.[60]

300. In Mexico, certain states have introduced a mandatory liability coverage for automobiles. On the whole, only 18 per cent of the country's automobiles are insured and mandatory insurance regulation is expected in the near future.[61]

301. In Panama, a law has been introduced in May 1993 that results in the cancellation of licences for public transport operators that do not buy the compulsory third party damage and liability insurance for their motor vehicles.[62]

302. Widespread debate in Thailand over the law on compulsory insurance has postponed its implementation by six months to April 1993. The central issues are setting of premium rates, fairness to the insured, overseeing the performance of insurers and the extent of coverage to be given.[63] Many insurers deem the premiums insufficient. Nevertheless, the Government has imposed steep fines for

insurers who fail to provide the cover.[64] While the cover was optional certain estimates indicated that fewer than five drivers had cover.[65] The cooperation of several banks has been secured in order to help sell the policies quickly.[66]

303. In the Gulf region, the Gulf Cooperation Council (GCC) has recommended that compulsory insurance regulations should reach a unified standard within the GCC.[67]

L. International agreements

304. On the international scene a number of "coloured card" schemes have been operative. Under such schemes, the loss or damage caused by a foreign vehicle is settled by local insurers who then have the right to seek reimbursement of their payments from the insurer who issued the international cover. These schemes function mainly through a network of national bureaux representing the insurers issuing such international covers. Settlements between national bureaux are very often effected after all payments made for the respective nations are balanced out.

305. Argentina, Bolivia, Brazil, Chile, Paraguay and Peru have introduced a uniform third party liability policy for commercial vehicles. The agreement means that damage caused by a foreign vehicle will be paid in the country where the accident took place.[68]

306. In 1987 the African Preferential Trade Agreement (PTA) countries introduced a "yellow card" system for third party motor insurance. Claims settled by the country in which the accident occurs are later reimbursed by the country that issued the yellow card.[69]

307. On the other hand, the introduction of an "orange card" is being hindered in the Arab countries by differences in the legal systems.[70]

308. A "brown card" system has been introduced in the Economic Community of West African States (ECOWAS).[71]

M. Multi-party multi-sectoral approaches

309. Solutions to problems of the motor insurance branch can be found only partially in the insurance sector itself. The problems arising in the settlement of claims require the involvement and participation of various, mostly public, agencies. These would include road and traffic departments, the police, the judiciary, health authorities, representatives of consumer associations, and the Government.

310. In a number of countries, "committees" comprising representatives of relevant public agencies and insurers have been set up (e.g. in Côte d'Ivoire and Malaysia) and have led to new regulations, new safety standards, road safety campaigns, and improvement of roads and health care systems.

311. In Chile, for example, new regulation has permitted hospitals to greatly improve their emergency services as they are now able to recover some of the costs incurred for treating traffic accident victims directly from the insurance companies.[72]

312. In the Republic of Korea, the Insurance Development Institute opened the Automobile Insurance Technology Institute (AITI) in March 1992. The AITI conducts research on automotive maintenance technology and educates compensation personnel and loss adjusters.[73] In March of the same year the Ministry of Finance introduced a motor insurance management appraisal system. Insurers would be graded by the Ministry on their financial situation, means of soliciting business and quality of service. Insufficient grades may result in the suspension of the insurer from writing motor business.[74]

313. The Casablanca African Insurance Reassessment Workshop of 1990 recommended that solutions to the problems of motor insurance have to be found partly outside the insurance sector, inter alia, through:

- The education of the public;
- Better roads and infrastructure;
- Better vehicle maintenance; and
- The enforcement of traffic regulations.

* * *

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Chapter V

FIRE INSURANCE

A. Introduction

314. Fire insurance, which on average represents about 25 per cent[1] of the total non-life business in developing countries, is an important line for insurers. This is particularly so since motor insurance produces losses for many companies in developing countries, while fire insurance is often profitable, and thus provides a cushion. To the extent that cross-subsidization takes place between profits of fire and losses of the motor section, the fairness of rates for fire policyholders is impaired. In the medium to long term, as markets develop and become more open, competition and policyholder awareness should bring down the profitability of fire insurance to conventional levels.

315. In Benin the fire branch has shown regular growth in both personal and commercial lines. It is a source of compensation for the loss-generating motor insurance sector.[2]

316. In Egypt fire insurance is the largest class of business and has produced steady profits in the past. Between 1986 and 1991 loss ratios varied from 16.3 per cent to 44.5 per cent on net account, while profits for 1991 were estimated at LE 72 million. By contrast, the compulsory motor line incurred a loss ratio of 166 per cent on net account the same year, with losses put at LE 60 million.[3]

317. In Chile the results for 1992 show a decrease in the claims ratio for fire lines and an increase for motor insurance.[4]

318. In Thailand fire insurance is subject to tariffs which are set by the Insurance Department. The advance in building quality and fire fighting techniques and the availability of water has caused a rise in profits.[5] Following up on this, the Insurance Department has cut fire tariff rates by 8.5 per cent. This, together with the issuance of IAR (all-risk insurance) policies to which the tariff does not apply, is expected to reduce the profitability of the sector.[6] Despite the general positive trend, the Kader Industrial factory fire in Bangkok is a reminder of the seriousness of safety problems that tend to follow a fast pace of industrial development. Certain reports note that, while the factory had a considerably comprehensive fire insurance cover, the factory design itself would not satisfy an acceptable fire protection standard.[7]

B. Loss ratios

319. Loss ratios in the fire business are commonly lower than 40 per cent. An UNCTAD statistical survey shows that out of 87 countries, 61 had loss ratios in fire lower than 40 per cent.[8] However, these statistics also show that events of a catastrophic nature may lead to a sudden rise in loss ratios. It may be noted that the primary impact of catastrophic losses is borne by fire insurance since the risks of flooding, tornado, cyclone, volcanic eruption and earthquake are usually written as an extension of a basic fire policy. Substantial fluctuations in loss ratios also occur because in a number of countries the markets are small and do not provide for sufficient homogeneity and a geographical spread of risks. Depending on the size of the market, a few major fires may turn a profit situation into one of severe loss.

320. In Chile fire loss ratios were 219 per cent in 1985 while only 63 and 84 per cent for 1984 and 1986 respectively.

321. In Mexico they were 169 per cent in 1985 while only 25 and 9.5 per cent in 1984 and 1986 respectively.

322. In Fiji they were 644 per cent in 1985 while only 58 per cent in 1984 and 113 per cent in 1986.[9]

C. Insurance awareness

323. A lack of awareness of the benefits of insurance is a serious handicap for the fire sector. It is generally believed that a large number or perhaps the majority of simple risks belonging to individuals, such as dwellings, shops and other small enterprises, and small sector and handicraft operations are without any insurance cover. As regards commercial and industrial enterprises, fire insurance is often required by a bank when it gives a loan. Still, a number of shortcomings may arise. The extent of insurance may be insufficient. The insured value may not have been adjusted for inflation, or the sum insured may be only to the extent of the loan availed. Further, the insurance may cover only the basic peril of fire and not extend to other insurable perils.

324. Fire insurance offers substantial potential for insurance expansion in developing countries as many small to medium-sized risks remain uninsured or underinsured. With the growth of their principal, be they personal effects or capital assets, the need to insure will develop. Insurers should make constant efforts to extend insurance to these entities, keeping in mind the long-term benefits of developing a broad client base, acquiring a sufficient number of homogeneous risks and diversifying the insurance portfolio.

325. In Thailand there is a widespread incidence of non-insurance among small to medium-sized businesses and in the simple risks category.[10] Similarly, in Mexico, the bulk of the premium comes from the commercial and industrial sectors while the home owners market is relatively underinsured.[11]

326. Another potential problem would be that a fire policy may not cover an adequate range of perils.

327. At the Casablanca African Insurance Reassessment Workshop of 1990, it was suggested that some classes of fire risks should be made compulsory (as is the case in some Laender in Germany and Cantons in Switzerland) as a measure to better protect the wealth of the country and improve the risk consciousness of the population. Needless to say, when such a decision is taken, the affordability of compulsory covers should be kept in mind.

D. Rating structure

328. Judging by the overall profitability of the fire business in developing countries, it would appear that premium rates are adequate. They may, however, hide a certain degree of arbitrary rate-setting. For example, the proportions for different hazards in the rate of the basic cover, particularly for catastrophe perils, may not be properly allocated. There may also be inter se rate distortions between various categories of risks, particularly between commercial risks and "mass risks". It is possible that for various reasons, in particular business volume and effective lobbying, comparatively favourable rates and terms and conditions are given to the former, while the interests of the latter are overlooked.

329. Continuous efforts are made to correct rating imbalances and rate distortions. In Malaysia, in April 1992 a new fire tariff was put into effect and the revised tariffs show both reductions and increases depending on the type of premises.[12] The tariff is to be reviewed periodically and rates would be adjusted to reflect experience with the different trades and occupancies. This would prevent the subsidization of classes that show adverse results.[13] In Pakistan, it is being argued that commercial ventures are buying, with increasing frequency, fire insurance at rates believed to be below the level of economic viability of the cover and that therefore a rate revision is pressing.[14] During the winter of 1991-1992 large losses were experienced in Israel and this is compelling insurers to contemplate a rate increase for commercial property and an introduction of separate rates for storm- and flood-related damage.[15]

330. Another weakness of the rating system for fire risks in developing countries is that incentives for risk improvement and loss prevention measures and penalties for substandard features are often poorly structured. For example, discounts for the installation of fire-fighting appliances, for the segregation of hazardous processes and materials, and for the subdivision of buildings to limit the size of a potential loss[16] could be made more effective. In conjunction with such discounts it will be necessary to have permanent periodical checks to verify that the installations are properly serviced. Similarly, the imposition of a loading following discovery of a deficiency in the risk may be considered. Such a loading should be withdrawn when the deficiency is set right. High-rise buildings and complex risks require special rating. Since reinsurance on these risks is often substantial, the rate suggested by the reinsurer often has to be accepted (see paras. 492-519).

331. In a number of countries the rating structure of fire risks has not received the necessary attention. This could be partly because the business has been profitable on the whole, and partly because of a feeling among insurers that a closer examination may result in a downward adjustment of rates. An even more important factor is the lack of statistical data and expertise required for a systematic analysis of the characteristics of various categories of risks. In a large number of countries the prevalent rates are derived historically, with ad hoc modifications to meet pressing exigencies. It is, therefore, necessary that markets introduce, wherever this is not the case, a systematic collection of sufficiently detailed statistics of fire and allied risks. Existing rates may require review with the aim of making them fair and equitable. The establishment of a cadre of qualified and experienced engineers, if the size of the market warrants it, may also be considered. This would go a long way in building up and promoting a culture of loss prevention and risk management.

332. In Turkey, the termination of the fire tariff regime initiated increased competition for the small number of medium-sized and large commercial and industrial risks. The absence of significant loss statistics contributed to a substantial rate reduction for these risks. On the other hand, the rates for personal property have remained at levels close to the old tariff ratings as, due to the big tally of individual risks, the law of large numbers allows for more objective rate setting.[17]

333. A loss register has been set up by the Asean Insurance Council to compile information on fire losses exceeding US$ 5 million. The goal of the register is to identify trends and patterns in fire losses and detect fraud through compiling and analysing data.[18]

334. In Indonesia, an Inter-Company Agreement has been signed with the aim of bringing fire rates back to economically viable levels. To support the agreement a data centre is to be established at the Insurance Council of Indonesia.[19]

E. Loss surveyors and assessors

335. A problem from which most of the developing countries suffer is related to the inadequate skills of surveyors and loss assessors, who tend to come to a conclusion about a loss by negotiating and bargaining with the policyholder, rather than through technical and strict quantification. In programmes of insurance education, provision should be made for upgrading the skills of auxiliary services, such as those of surveyors.

F. Pooling arrangements

336. In order to have access to a larger number of risks and to benefit from a better spread, a number of pooling arrangements have been set up within or among developing countries. The results have been generally profitable for participating companies. However, for various reasons, the scope of these pools has not sufficiently increased.

337. The African Fire Pool (AFP) has not succeeded in attaining its membership and premium income target. However, it is planning to attain US$ 3 million as premium income for 1993. Once this is achieved, the AFP will be able to consider the selective underwriting of facultative business.[20] Recent reports have diminished expectations as premiums written in 1992 totalled US$ 315,586. The African Oil and Energy Risks Insurance Pool has reported a reduction in subscribed capacity, currently at US$ 2.83 million, while its membership increased to 22 and underwriting results showed a profit for 1992 after a loss in 1991.[21]

338. In the Republic of Korea all large industrial and commercial business could previously be insured only through the industrial fire pool shared until recently by 11 domestic companies. The entry of two United States companies into the pool displeased the original members to the extent that the major Korean insurers are withdrawing and its use is being phased out. The pool is mandatory for buildings with more than six floors and for factories in nine designated cities. Even these requirements were to be terminated by 1 October 1992.[22]

G. Reinsurance

339. Fire insurance in developing countries is substantially reinsured. An UNCTAD statistical survey of 97 developing countries showed that 53 per cent of them retained less than 50 per cent of business underwritten, and 28 per cent retained less than 30 per cent (figure 2). The question to be asked is why are retentions low on a business that is generally profitable? Among the various explanations advanced are:

- Capital constraints limit domestic insurance capacity;
- The proportion of large risks in domestic companies' portfolios has increased in recent years;
- Underwriting commercial and industrial risks is a complex task which requires considerable expertise and experience;
- Insurers have not analysed risks in depth and often have little notion of the probable maximum loss (PML);
- In view of the uncertainty as to whether a positive underwriting result can be achieved, insurers frequently prefer a sure commission to a potential profit;
- Some risks have a high import content, and in the event of a loss requiring foreign exchange for replacement this problem can be eased by reinsurance abroad.

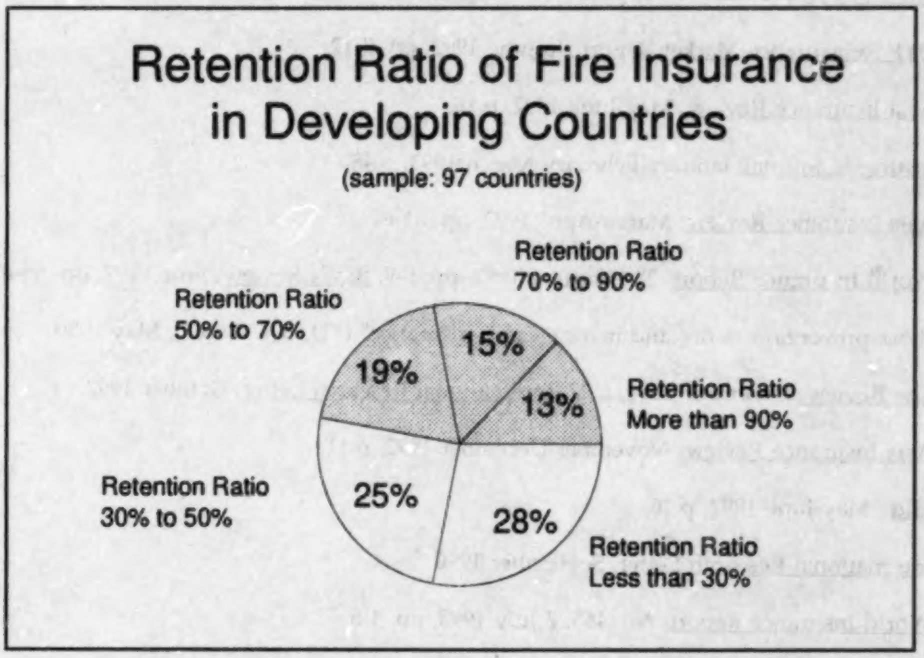
340. It follows that the pricing of fire insurance is heavily influenced by developments on the international market. In Indonesia, during the formation of the fire tariff within the Inter-Company Agreement, the forum of professional reinsurers in Jakarta secured the approval of overseas reinsurers, which provide capacity beyond that available locally. The Agreement itself will be monitored by Indo Re.[23] In Mexico, commercial and industrial risks are mainly reinsured abroad because of the high exposure and low retention capacities of domestic insurers. For this reason, the pricing of fire insurance is under considerable influence from international reinsurers.[24]

341. On adoption of an "open-door" policy by Viet Nam in 1988, the state insurer Baoviet is placing its facultative fire reinsurance in the London market.[25]

342. It would be advantageous for markets to pay greater attention to the technical aspects of risk evaluation and build up expertise and a capacity for proper rating of these risks as they grow.

343. Retentions are determined in a large number of developing countries on the basis of the total sum insured under the policy. Depending upon the expertise available, setting retentions on the basis of PML may be considered. This would ensure that retentions correspond more closely to the potential loss. At the same time caution is necessary because a wrong application of PML underwriting may expose the net account of the insurer.

Figure 2



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18. Asia Insurance Review, November-December 1992, p.11.

19. Ibid., May-June 1992, p.16.

20. International Research Letter, September 1990.

21. World Insurance Report, No. 465, 2 July 1993, pp. 4-5.

22. The International Broker, January 1991; Business Insurance, 3 August 1992, p.19.

23. The Review, February 1993, p.34.

24. DYP Reinsurance Market Report, 16 June 1992, pp. 7-12.

25. World Insurance Corporate Report, No. 43, 11 May 1990, p.5.

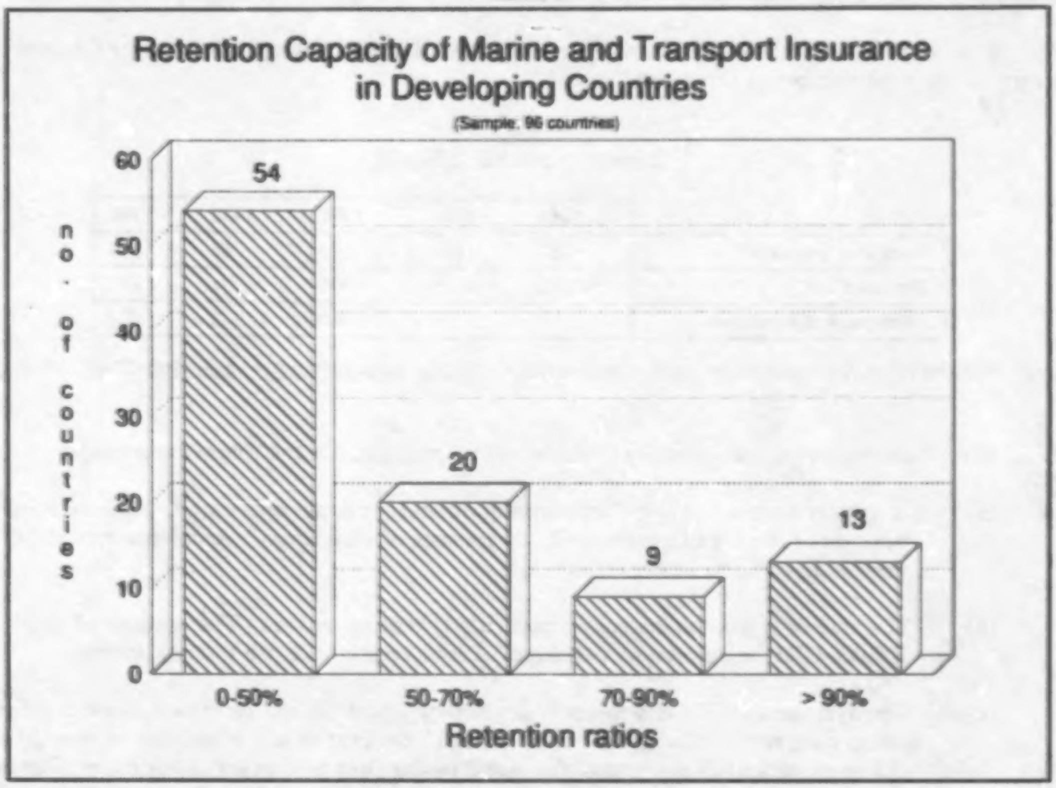
Chapter VI

MARINE AND TRANSPORT INSURANCE

A. Introduction

344. Issues of concern to the marine insurance sector in developing countries include the cyclical nature of the business, the safety of ships, infrastructural deficiencies, the role of classification societies, maritime crime and the localization of risks. In general, the retention ratios for marine and transport are lower than for motor or fire (figure 3). As a consequence, the operation of the marine and transport insurance sector is greatly influenced by events in the international marine insurance market.

Figure 3



Source: Statistical Survey on Insurance and Reinsurance in Developing Countries 1983-1990, UNCTAD, 1994.

345. International marine insurance has a cyclical character. Prevailing market conditions are affected by variations in capacity. Over-capacity has led to rate reductions, more generous terms and conditions, and greater discounts. The market was also influenced by conditions in the shipping industry which recently passed through a recession. Of late, marine insurance rates are hardening, particularly in the hull department. It has been reported that for the first time in the past 20 years there are prospects for growth in the international marine insurance sector.[1] In his address at the 1992 annual meeting of the Institute of London Underwriters, the outgoing chairman said that "a promising degree of stabilization had been achieved... at last the marine market has turned upwards in a positive and encouraging manner..."[2] Apart

from a further rate increase of between 25 and 30 per cent during the beginning of 1993, hull deductibles have increased four to five times over the previous two years. In addition, rates have become highly discriminative for different risks. While hull rates used to span between 0.75 to 1 per cent, depending on the quality of the risk, today they range between 1.5 and 15 per cent.[3] Subsequently, insurers in developing countries may have to raise their net retentions, increase rates and enlarge the level of deductibles.

B. Safety of ships

346. The safety of ships is of great concern to the marine insurance sector since it affects both the cargo and the hull business. Losses in terms of number of ships and their deadweight have been declining in the last few years (see table 6). Losses in terms of deadweight in 1990 amounted to less than a quarter of the 1986 figures. The number of ships lost does not give the total picture of insurance claims since partial losses also occur. These give rise to both repair costs and general average claims on cargo.

347. It is worth noting that in 1991 ships operating under flags of convenience accounted for about 30 per cent of the total number of ships lost.[4]

Table 6
Shipping tonnage lost 1986-1990

	1986	1987	1988	1989	1990
Number of ships lost	358	284	271	247	175
Thousand dwt	6,810	3,125	1,905	1,061	1,680
Percentage of world fleet	1.1	0.5	0.3	0.2	0.2

Source: Maritime Information Services Ltd., London, quoted in UNCTAD, Review of Maritime Transport 1990 (TD/B/C.4/340), p. 82.

348. Risks have increased substantially over the years, inter alia, for the following reasons:

(a) A greater number of ships are carrying oil and/or dangerous cargo. Approximately 35 per cent of the world's seaborne trade consists of such cargo.[5] Accidents involving these vessels give rise to heavy claims.

(b) The size of ships has increased, particularly that of tankers. The number of ships over 100,000 GRT has grown to 498 ships.[6] Large vessels increase the risk factor.

(c) The average age of many fleets in developing countries has increased as older ships are not getting replaced with new ones. Over 15 per cent of the world fleet is now 20 years old or more, and 73 per cent of the world tanker fleet is 10 years old or more. Out of the total losses of 258 ships in 1991, 192 ships were more than 15 years of age. They accounted for 75 per cent of the losses, which indicates a positive relationship between vessel age and the risk factor.[7]

(d) Resource squeezes due to frequent recessions in the shipping industry, particularly the last one which lasted for nearly a decade, have resulted in a general fall in maintenance standards, with an obvious toll on safety.

(e) There has also been a deterioration in operational standards and the quality of crews manning ships.

(f) There is an increasing shortage of trained and experienced personnel and a lack of training facilities. According to a study carried out by the International Shipping Federation (ISF) and the Baltic and International Maritime Council (BIMCO), this shortage is likely to become progressively greater.

349. World maritime safety has evolved along with the shipping industry. Most of the rules, regulations and standards related to safety are the consequence of maritime disasters with the attendant public criticism, liability claims and subsequent legislation. It is assumed that a ship constructed in accordance with the rules of an established classification society and maintained in classification and complying with the International Safety Conventions would constitute a good risk as far as insurance is concerned.

350. In spite of a plethora of international regulations concerning safety and the protection of the environment, maritime disasters continue to occur. Sea pollution and environmental hazards, and the attendant new legislation have become a major issue for underwriters, shipowners and P & I clubs. Speculation abounds as to whether the United States Oil Pollution Act will be appropriated in the legislation of other countries. Increasing safety by applying more sophisticated construction designs, such as double hull, may enlarge insured values and premiums and increase rather than decrease rates as repair costs will be expected to rise.[8]

Underwriting and classification societies

351. Traditionally, underwriters approach the matter of maritime losses from a financial point of view, balancing claims (paid and outstanding) with premium charged. The quality of fleet management and fleet technical characteristics has not been given sufficient importance. At a conference of the International Union of Marine Insurances (IUMI) held in Bern in September 1992, it was recommended that "in addition to analyzing loss history, underwriters should seek to assess the technical standards of shipowners' vessels, the standard of its crew and of the owner's management".[9]

352. In this respect, the working of classification societies is very relevant to marine insurance. The societies control the technical aspects of ship construction and maintenance. They inspect ships and issue reports pointing out defects and recommending steps to be taken. The shipowners are expected to take the necessary action to maintain the classification of ships. Underwriters typically accept the certificate of classification issued by recognized societies and underwrite risks on this basis.

353. In recent years some marine underwriters have expressed dissatisfaction with the working of classification societies. It has been reported that, for commercial considerations arising out of competition, classification societies have compromised on standards.[10] For example, when a ship is required to be dry-docked for survey (and repairs) by a society, some other society may agree to continue the classification on the basis of a superficial survey and deferment of repairs. Some underwriters have, therefore, found it expedient to have independent surveys of ships, with reports submitted directly to themselves. Sometimes a "condition" survey, which is general in nature, and sometimes a "structural" survey, which is a comprehensive survey after dry-docking, is required by underwriters. In 1992, the London market introduced the structural condition survey warranty. Underwriters may target individual ships for this survey which is entrusted to the Salvage Association. Up to June 1993, 80 per cent of ships directed to the survey were found in need of significant work, in particular steel renewal.[11] While underwriters may be justified in taking such precautionary steps, a duplication of function should be avoided. The infrastructure and expertise developed by the classification societies should be utilized.

354. Marine insurers may consider taking greater interest in the working of classification societies so that the surveys done and certificates issued are more in line with the requirements of underwriting. In

fact, it has been suggested that, in order to restore confidence in the working of the societies, a thorough assessment of the entire structure under which the societies operate is necessary.[12]

355. Grading of ships by societies in accordance with their condition may be of help to marine underwriters. At present a one-class notation is used as long as minimum standards are complied with. The notation is maintained throughout the life of the ship, irrespective of age and level of maintenance.

356. On their part, the classification societies should improve their methods. Instead of non-exclusive (freelance) surveyors, the societies can use the services of other societies recognized by the International Association of Classification Societies (IACS) or the local classification society in an area where the particular society may not have proper representation. It has been reported that the IACS is evolving a code of conduct for its members and has issued a directive to them that they should implement a quality management system in their own organizations and should have that system audited and certified by its Quality Committee. Competition amongst various societies should not lead to sacrificing the quality of standards.

Problems of developing countries

357. About 22 per cent of the present world tonnage belongs to developing countries.[13] A number of developing countries are endeavouring to establish or further expand their own mercantile fleets. In doing so they encounter, inter alia the following problems which are of relevance for insurers.

(a) A lack of infrastructure for implementing safety standards. Many developing countries have virtually no maritime administrative authority to supervise and monitor the fleet in terms of safety requirements.

(b) A lack of dry-docking or repair facilities often leads to a postponement of surveys to ascertain the safety of ships and to carry out the required repairs or renewal.

(c) Only a few developing countries have classification societies of their own. They are Brazil, China, Cuba, Democratic People's Republic of Korea, India, Indonesia, Islamic Republic of Iran, Mexico, Republic of Korea, and Turkey. Only the societies of China and the Republic of Korea have been admitted as members of the IACS. India has been admitted as an associate member.[14]

(d) Developing countries find it increasingly difficult to man their fleets properly. Due to the inability to pay according to international standards and a lack of tax concessions for maritime personnel, recourse is sought in hiring inexpensive labour with poor qualifications in order to stay competitive.

C. Multimodal transport regime

358. Insurance companies are interested in the terms of contracts for carriage of goods, as this affects their eventual liability. With the containerization of cargo, the cargo proceeds from the point of origin to the point of final destination without any checking. Similarly, the cargo could be carried on a road vehicle which could roll on and off a ferry without any discharge when the mode of transportation is changed. Under such a system it is natural for one and the same operator to undertake responsibility for the entire transport. The United Nations Convention on International Multimodal Transport of Goods, 1980 (the MT Convention) is intended to create a measure of uniformity in multimodal transport. The Convention requires 30 contracting parties to enter into force. As of November 1993, it had as contracting parties Chile, Malawi, Mexico, Morocco, Rwanda, Senegal and Zambia. One of the reasons for the delay in more countries becoming contracting parties has been the entry into force, only recently, on 1

November 1992, of the United Nations Convention on the Carriage of Goods by Sea 1978,[15] on which the system of liability of the MT Convention is modelled. Pending the entry into force of the MT Convention, the UNCTAD secretariat prepared, in conjunction with the ICC, a set of Rules for Multimodal Transport Documents aimed at avoiding a multiplicity of different regimes governing such transportation, and providing for a private transport contract based on the Hague-Visby Rules liability system. The Rules, which became operational on 1 January 1992, apply only when they are referred to in the multimodal transport contract. The Rules retained the network liability system to the effect that the multimodal transport operator, and not only the consignor, may invoke the mandatory liability rules of international conventions and national law that would have applied if a separate and direct contract had been issued for the particular stage of the transport where the loss or damage occurred. Thus, the application of the Rules in countries subject to the Hamburg Rules regime would mean that the limits of liability of the Hamburg Rules would apply and the particular defences of nautical fault and of fire retained by the UNCTAD/ICC Rules will be superseded by the Convention.

D. Maritime crime and fraud

359. Maritime crimes continue to grow in complexity and sophistication. The alarming factor is that the majority of crimes today are committed by "organized gangs/syndicates". A fraudulent misrepresentation or non-disclosure to underwriters of a material fact concerning the value of the hull or cargo is the basis of insurance fraud. However, the liability for all maritime crimes does not fall on insurers. For example, in documentary frauds, where the cargo does not exist, there is no insurable interest and the loss is outside the scope of the insurance contract. Nevertheless, claims are made on insurers by parties that have suffered losses and insurers have to go through the process of detailed inquiries, investigations and often extremely costly legal proceedings to establish that liability does not attach to them. The International Maritime Bureau points out that a certificate of insurance is a specified document in a letter of credit, and while the insurer is not at risk if the goods are non-existent, the certificate can be used to give credibility to a criminal transaction.[16] It is, therefore, necessary for insurers to understand the ramifications of maritime crime. The frauds that are encountered can be classified as those relating to documentation, charter party, deviation and piracy, and insurance fraud and scuttling.[17]

Documentary frauds

360. A documentary fraud is the use of forged or falsified shipping documents and occurs when trade is effected on documentary credit terms. Several examples of documentary fraud are presented as follows.

361. Oil frauds: Since 1989, offers for the sale of crude oil ex. Nigeria have victimized hundreds of buyers. In a typical example, oil is offered at a substantially discounted price. The buyer is asked to open a letter of credit which is encashable after the vessel reaches its destination. The sellers prepare false documents and copy these to the buyer. The buyer is then asked for an advance sum of US$ 250,000 (typical amount) to cover "port expenses" of the vessel. The buyer pays this amount to the seller and awaits the vessel's arrival at the discharge port. In reality, the shipment belongs to another buyer and the victim discovers this only after the vessel reaches its destination. Despite warnings in the press, this type of fraud continues.

362. Cigarettes: Since the middle of 1990 the sale of non-existent cigarettes has been on the increase. Unscrupulous sellers offer container loads of surplus brand-name cigarettes at discounted rates. Sellers cash the letters of credit by presenting false documents. In some instances, reputable agencies had issued 'pre-shipment inspection certificates' by examining the goods in warehouses. The actual containers when shipped were empty. The insurance policies in many instances were genuine.

363. Other types: Lately, fraudsters have targeted Commonwealth of Independent States (CIS) countries. In a recent case, a company from one of the CIS countries was cheated of US$ 2.5 million when

it paid for a shipment of non-existent sugar. Lack of commercial know-how may have been instrumental in this fraud. The offer for the sale of the sugar had said "price - c & f $265 from a South American port to any port in the world".

Charter party frauds

364. Charter party frauds reached a peak in the mid-1980s. In a typical case a time charterer, having collected the freight, would abscond leaving the cargo owners and the carrier to resolve the matter. The cargo interests ended up paying double freight for the vessel to complete the voyage. Fortunately these frauds have declined and there has been only one reported case since 1990.

Deviation

365. In the 1980s over 30 vessels illegally deviated into Lebanon and sold cargo. In most instances, the cargo was unrecoverable and the cargo insurers had to suffer considerable losses. In some cases, it has been possible to recover the cargo through quick action. The last such recovery was in December 1990 for a cargo of aluminum worth US$ 8 million. This was achieved with the support of the Lebanese Government. Since then there have been no further illegal deviations into Lebanon.

Piracy

366. Piracy has emerged as a real problem, particularly in South-East Asia. Around 450 pirate raids have been reported to the International Maritime Organization since 1984 and it is estimated that this figure covers only half of the total number of incidents.[18] Apart from hull and cargo losses, the lives of the crew and officers are often lost. Several types of piracy are described below.

367. Short-term seizure: Vessels underway are boarded by armed pirates in the Malacca Straits and the Philippine Channel. The attackers rob the crew of their personal effects and the ship's cash. There were over 160 reported attacks in 1991. The actual figure is likely to be higher.

368. Long-term seizure: Vessels underway loaded with cargo are boarded by armed pirates who overpower the crew and force them to anchor at remote locations. The entire cargoes are offloaded into barges before the vessels are released. These attacks usually happen at night in the Gulf of Thailand and the South China sea. There have been six reported incidents between 1989 and 1992. Incidents of robbery have been reported of vessels at anchor in Lagos lagoon. Typically, the cargo is offloaded at night on to pontoons or barges and carried onshore.

369. Permanent seizure: A vessel underway or at anchor is boarded by armed pirates, not so much for the cargo but to hijack the vessel and trade with it. The vessel is given a false identity and is used to load legitimate cargo after which she deviates into an unscheduled port. The cargo is sold to unsuspecting buyers. Then the name of the vessel is once again changed and the thefts continue. Sometimes the ship is also sold.

370. It has been reported that a pirate syndicate based in the Philippines is responsible for cargo theft valued at US$ 20 million in the year 1991. According to the International Maritime Bureau, the syndicate is believed to have links throughout South-East Asia. The pirates operate two vessels under temporary registration while the crew travels on false passports. Cargo is stolen from companies in need of transport on short notice and is sold through brokers in the region.[19]

371. Insurers may consider raising premiums on policies for vessels plying waters subject to frequent piracy. Many insurers include piracy among general risks covered by the policy and it is possible that it may be excluded in the future or a specific premium may be charged. In response to the critical

situation, Indonesia and Singapore are coordinating naval patrols and have increased information exchange on piracy with the immediate effect of reducing pirate raids in the region.[20]

Scuttling

372. Another area of concern to marine underwriters is the scuttling (intentional sinking) of an over-insured vessel. Further, the scuttled vessel may have carried over-insured or non-existent but insured cargo. Variations of the above scenarios are numerous. For example, the shipowner can use scuttling as a means of hiding the fact that he has stolen cargo and sold it clandestinely before the sinking. This can also be classified as a deviation fraud. In order for the insurer to avoid paying such claims (assuming a prima facie case has been made by the assured for loss from an insured peril) he must prove that the vessel was intentionally sunk as well as the complicity of the assured in the act. This is often factually a difficult task, in that evidence is frequently unavailable and, in some national legal systems, legally difficult to establish as well. Another variation of the scuttling scenario is to arrange an entirely bogus disappearance, whereby the vessel later "reappears" under the guise of a new name and nationality.[21]

373. Yet another type of fraud in marine insurance relates to an intentional overstatement as to the size of an insured consignment. As a result of this overstatement, a claim can be made by the consignee against insurers for alleged non-delivery of what was, in fact, the non-existent part of the consignment. Such frauds have often occurred in connection with an arranged over-invoicing by an accommodating seller at the behest of a buyer wishing to obtain excess foreign currency from the central bank of his home country which has imposed currency exchange controls.[22]

374. Marine insurers of developing countries often suffer losses from maritime crime and fraud due to inexperience and/or lack of information and the manner in which trade is conducted in their country. If the company is small the underwriter might not thoroughly check the shipping documents, the antecedents of the trading parties, and the status of the vessel. It is also possible that the requirement of immediate notification of loss or damage is not enforced. The underwriter may not have access to or make full use of the internationally available information about ships, their owners, charters, corporate history, etc. Expertise may also be lacking in respect of the follow-up action to be taken once a suspicion has arisen. The insured may also not be well organized or fully familiar with the intricacies of international trade. It has to be realized that the international criminal often has much experience and, in any case, the advantage of pre-planning. Support from other related agencies may also be lacking. For example, the shore authorities may be slack or the law enforcement agencies may not be prompt in pursuing a reported case. It has even been reported that in many cases the victim vessel, when caught in an incident, merely informs the owner's headquarters or its agent, but fails to report the crime to the shore law enforcement agencies, pleading that communication has broken down.[23] Most importantly, there is no agency or focal point where all incidents of maritime crime are reported and expertise developed to take remedial action.

375. The insurance sector in India has introduced a system of verification of ships bringing full-vessel-load imports and of all ships carrying exports. Verification of part-load vessels for imports has not been found practical. On receiving an application, three aspects are examined. First, operational aspects, such as who has issued the bill of lading and on whose behalf it has been executed, and who is the operator, charterer or owner of the vessel, are examined. Secondly, financial aspects, such as the financial standing and bank report on the parties involved, are verified. Thirdly, the details of the ship, such as the year built, classification status, and whether any mandatory survey is pending, are investigated. If the application does not meet with the required standards, a penal rate is charged in addition to the usual marine insurance rate. This has helped to reduce the incidence of maritime fraud considerably.[24]

E. Loss prevention

376. Loss prevention has an important role to play in marine insurance. The IUMI issued a brochure entitled "Cargo loss prevention recommendations in 1974".[25] Many of these recommendations are still valid for a large number of developing countries. Two studies entitled "Loss prevention in fire and marine cargo insurance", and "Cargo loss prevention: suggestion for a domestic policy in developing countries" have been made by the UNCTAD secretariat.[26]

377. A large number of marine insurance losses in developing countries occur in port. While inadequate facilities at ports are a matter of overall infrastructural deficiency, the insurance sector can voice its concern and help create the necessary atmosphere for improvement of the situation.

378. Various steps can also be taken by the insurance industry to minimize or prevent losses. The Subregional Colloquium on Marine Insurance, held at Douala in October 1989, recommended:

"That shippers and insurers should take the following steps to improve loss experience:

a. Individual insurers and their national/subregional associations to:

- Estimate total costs of different types of loss and establish priorities for remedial action;
- Cooperate with shippers in tackling major problem areas, including lobbying of Governments to ensure support in promoting procedural and security improvements;
- Produce simple loss prevention leaflets for handing to policyholders when cover is taken out, explaining assureds' obligations;
- Agree on packaging or preparation standards to be accepted in conjunction with shippers' associations;
- Combine in employing surveyors in ports to perform pre-discharge surveys and to supervise unloading of key cargoes.

b. Individual shippers and their sectoral associations to:

- Estimate quantity, frequency and cost of various losses affecting them (isolating place of loss such as ship, port and inland);
- Estimate cost of preventing given types of losses and the likely savings;
- Assess proportions of losses borne by insurers and assureds;
- Assess possibilities of joint funding and joint preventing action between insurers and assureds;
- Concentrate on a few specific problem areas at one time; initially on low cost and no-cost measures;
- Draw the attention of port authorities in conjunction with other transport and handling auxiliaries to take appropriate measures to improve security and protection of goods;

- Encourage if possible importers' and exporters' associations to lease port facilities under their direct control with autonomous theft and weather protection;
- Identify and avoid the use of operators with poor records;
- Discuss at association level and individually with insurers a system of premiums tailored to assured's own record (this implies remaining with same insurer);
- Request shippers' councils to disseminate existing information on packaging, preparation and handling methods and to organize research where specific information (is) not yet available;
- Agree non-standard packaging in advance with insurers or agree general packaging standards with insurers' associations;
- Prepare simple loss prevention guidelines and information through relevant associations and all available media;
- Organize selective pre-shipment inspection where problems are suspected in the country of origin;
- Organize regular, pre-discharge surveys in conjunction with insurers;
- Exchange confidential information on poor operators within sub-region, split costs of research between countries (or split tasks), exchange information on own experience."

F. Localization of risks

379. Following resolution 42 (III) on the subject of insurance and reinsurance adopted by the United Nations Conference on Trade and Development at its third session in 1972, and resolution 9 (VII) on the subject of marine cargo insurance, adopted by the Committee on Invisibles and Financing related to Trade at its seventh session in 1975, several developing countries have enacted rules and regulations for the localization of marine cargo insurance on imports. These rules have, however, encountered some problems in their application. An UNCTAD report of November 1989 noted that "the provisions have been circumvented for all practical purposes through dubious business practices which increase the cost of imported goods".[27] The utility of localization of insurance on imported cargo is being increasingly questioned.

380. In Thailand, measures are being considered to stimulate exporters to take out local cargo insurance instead of selling on a "free on board" basis. It was argued that this would stimulate the domestic insurance business and reduce foreign currency outflow.[28]

381. In Africa, despite attempts to increase local cargo insurance, importers continue to buy all-risks cover in foreign markets while usually buying only the minimum required protection locally. The existence of this double insurance is primarily a result of the lack of confidence in domestic insurers.[29]

382. In Benin, the domestic insurance of imports has been compulsory since 1983. This has kept this insurance branch alive despite the reduction of the national maritime vessel fleet.[30]

383. Togo instituted a law in 1987 by which imports are to be insured locally, in accordance with resolution 9 (VII) adopted in 1975 by the seventh session of the Committee on Invisibles and Financing related to Trade, which was devoted to insurance.[31]

H. Loss assessment

384. A major problem encountered by many developing countries in respect to marine insurance is their lack of qualified and experienced loss assessors and loss adjustors. The result can be that marine insurance rates for shipment to the respective country become more expensive. Training persons in this profession in developing countries may be identified as a priority area.

385. With respect to the handling of losses, amendments made by Chile to the commercial code may bring major changes in how losses are adjusted in the country in the future:

- The burden of proof is softened, and the insured will only need to come up with a presumption on the cause of the loss and indicate the events "that presumably caused the loss".
- While insurance cannot be a means of profit for the insured, the amount insured can be as high as the amount that could reasonably be obtained by the insured from the sale of the goods.[32]

I. Landlocked countries

386. During the period under review some landlocked countries, such as Malawi and Zimbabwe, continued to have difficulties finding insurance for their mutual exports and imports, which have to transit through insecure regions disrupted by war and unrest. This seriously affects the trading potential of these countries.[33]

387. Apart from the issue of passage through troubled areas, landlocked countries generally face many difficulties regarding insurance of their imports and exports. These can be summarized as follows:

- The insurance sector in the country may not be sufficiently developed, and heavy reliance may have to be placed on insurance or substantial reinsurance outside the country of both imports and exports;
- Since the volume of business is small and unbalanced, inasfar as there is disequilibrium between total premium income and the occasional high value of a few shipments, rates, terms and conditions of insurance or reinsurance may be potentially hard;
- There have to be transshipments; in addition to transshipment at the port of entry, there may be transshipments at the national border. This considerably increases risk;
- The country through which the goods have to pass often insists on customs verification for its own security, and unpacking and repacking may be required. This, again, increases the risk and confronts insurers with problems of surveillance at foreign destinations for insurers.

388. Four specific measures have been recommended to alleviate the difficulties encountered.[34] First, governments may lift restrictions on the choice of insurer and may allow local insurers to seek agency appointments from larger marine insurers in international markets. Secondly, local insurers should attempt to obtain more extensive and comprehensive reinsurance facilities from their international reinsurers. Thirdly, they should invest in loss prevention and loss minimization schemes. Zambia and Zimbabwe have appointed professional firms in the port of Dar es Salaam to oversee the unloading of shipments destined for those countries and ascertain any loss or damage.[35] Fourthly, transporters and warehouse operators have to be made accountable for the safe delivery of goods in their custody.

I. Inland transit

389. Marine insurers in developing countries also encounter heavy losses on insurance of goods transported by road. In many developing countries the railways are not able to bear the growing load, and, in spite of the shortage of petroleum-based fuel, road traffic is important. Often, roads are in poor condition and vehicles are defective, making breakdowns frequent. Trucks often do not have a metal container, and goods are merely loosely covered by plastic or some other material. There are many stopovers and obstacles on the way. Incidents of pilferage, theft and robbery are common.

390. Cargo insurers in Singapore and Romania report an increase in claims for thefts and violent robberies during inland transit or while goods are in warehouses and depots. A significant increase in losses in inland transport between Hong Kong and China has been reported. Robbery and hijacking have been on the increase in Viet Nam and Cambodia and insurers in Singapore are excluding these risks or charging substantially higher premiums.[36]

391. A special feature in many developing countries is that, in order to promote employment and entrepreneurship, individuals have been given loans by financial institutions to acquire and run trucks for inland transportation. These individuals, in fact, become one-truck operators and are owner-cum-drivers. From the insurance point of view, there is a problem in fixing liability on them for negligence. Insurance companies, therefore, often find that they are unable to make recovery for the carrier's liability from these transporters.

K. Aviation insurance

392. Aviation insurance encompasses the insurance of airlines, manufacturers, airports, cargo and liability, and is characterized by reinsurance overcapacity and low rates. It is believed that throughout 1992 200 per cent of any risk could have been placed in the market.[37] Nevertheless, rate increases during this period have gained momentum as a result of global losses exceeding global premium income for four straight years.[38]

393. The reduction of the number of players in the market has been an immediate consequence. A decrease in the number of insurers and the concentration of existing capacity, along with the disappearance of principal carriers and the merging of major airlines, has led to a structural change in aviation insurance.[39]

394. Due to low retention and their practice of merely fronting aviation insurance, direct insurers in developing countries generally follow the terms and conditions set by the international market. It has been reported that a substantial portion of the rate increases has been born by airlines from developing countries. In contrast, the larger airlines of the developed countries and the Far East, being major insurance customers, have "received more favourable treatment, with exceptions where operators had a very bad loss record."[40]

395. Despite generally lower rate increases in the 1992 spring renewal amounting to 50 per cent, in comparison to 200 per cent of the 1991 autumn renewal, airlines in the Bahamas and Nigeria have been quoted rate increases of 100 per cent.[41] In Brazil, the renewal for the fleet of Viaco Aera in 1993 cost 54 per cent more than the previous year, even though the airline reduced its fleet from 42 to 23 airplanes. The local direct insurers have ceded 95 per cent of the risk.[42]

396. Carriers of some developing countries have found pooling arrangements useful. Fleets can be insured or reinsured in the international markets together in one slip on a pool basis. If it is considered more convenient to insure them separately, a pool can be formed on the basis of an agreed cession by each of the airlines out of their reinsurance placement.

397. The Airline Mutual Insurance facility was established by I.A.T.A. in Bermuda and is open to all I.A.T.A. members. The Airline Mutual Insurance deserves special notice, since many major airlines, both from developed and developing markets, are members.

398. The African Aviation Pool, managed by Africa Re, Casablanca, showed an underwriting profit and a slight drop in capacity in 1992. Premiums written increased by 73 per cent as a result of the general upward adjustment of aviation rates on the international market.[43]

* * *

Notes

1. ReActions, September 1991, p. 113.

2. Reinsurance, March 1992, p. 7.

3. Business Insurance, 8 February 1993, p. 23.

4. Lloyd's Register, Statistical Tables 1991, table 5, p. 53.

5. Ibid., table 2, pp. 10-16.

6. Ibid., table 26, p. 5.

7. Ibid., table 11, p. 26.

8. Asia Insurance Review, May-June 1992, p. 32.

9. Business Insurance, 21 September 1992, p. 47.

10. Brockbank, Mark E., "The crisis in the marine insurance market", paper presented at the Seminar on Marine Insurance and Average, Genoa, June 1992, p. 10.

11. The Review, September 1993, p. 51. Up to June 1993 a total of 133 ships were selected for survey.

12. Ibid., p. 11.

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28. World Insurance Report, No. 387, 11 May 1990, p. 3.

29. Ibid., No. 364, 9 June 1989, pp. 2-3.

30. L'Argus, 26 April 1992.

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38. The Review, June 1993, pp. 18-19.

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Chapter VI.

INSURANCE OF INTERNATIONAL CONTRACTS AND OTHER INSURANCES

A. Introduction

399. The insurance of international contracts aims to provide stability to international trade and investment. International enterprise faces both political and commercial risks. The insurance of political risks represents a distinct category in that it indemnifies a business when a foreign government does not abide by agreed contractual terms for the export or import of goods and services, or does not honour rights granted to an investor. Further, political risk insurance may cover losses when the contracting parties are both non-state entities but one defaults on its contractual obligations, involving trade or investment, due to unexpected, discriminatory or arbitrary acts of its government.

400. In practice, though, the insurance of international contracts is typically classified into two categories: trade and political risk insurance.

401. More broadly, the insurance of trade contracts consists of export credit insurance and import insurance. Export credit insurance provides cover for risks encountered by the seller. It is the converse of import insurance, or buyer's risk, where the buyer purchases a policy covering losses caused by non-delivery, or losses due to penalties paid, if he cannot complete performance to parties further down the line. Both export credit and import insurance may address commercial and/or political risk.

402. Political risk, as a category separate from risks encountered in trade, often refers to the insurance of international investment. By definition, the international investor retains commercial risks, as this is central to the risk and profit assessment of the venture, but seeks political risk insurance. It is observed that the insurance of international investment contracts against political risk is sometimes called, simply, political risk insurance.[1] The different types of insurance, common names of types of cover and risks addressed are presented schematically in table 7.

Table 7
Insurance of international contracts

Type of insurance	Common name / Type of cover	Risk covered
Insurance of International Trade Contracts	Export Credit Insurance	Political risk
		Commercial risk
	Buyer's Risk Insurance	Political risk
		Commercial risk
Insurance of International Investment Contracts	Political Risk Insurance	Political risk

B. Insurance of international trade contracts

403. The volume of trade between developed market economy countries (DMECs) and developing countries (DCs), and among developing countries themselves is growing. Trade between DMECs and DCs amounts to around US$ 450 billion annually and represents 14 per cent of world trade. Trade among developing countries is valued at about US$ 200 billion annually (175 billion excluding OPEC) and represents 30 per cent of the trade of developing countries.[2] While trade growth has been decelerating

or only mildly accelerating in the DMECs-DMECs or DMECs-DCs context, a substantial acceleration has been experienced in trade among developing countries (see table 8). The insurance sector of developing countries may have to dedicate more attention to the issue of developing export credit and import insurance for trade among developing countries.

Table 8
Network of world trade: Annual average growth rates of exports
(in per cent)

	Developed Market Economy Countries (DMECs)		Total Developing Countries (DCs)		Non-OPEC Developing Countries		Organization of the Petroleum Exporting Countries (OPEC)	
	'84-'86 '87-'89	'87-'89 '90-'91	'84-'86 '87-'89	'87-'89 '90-'91	'84-'86 '87-'89	'87-'89 '90-'91	'84-'86 '87-'89	'87-'89 '90-'91
DMECs	15.0	9.8	10.9	12.4	15.1	12.7	-2.2	10.9
Total DCs	8.0	8.7	5.2	13.6	5.9	14.9	1.6	6.9
Non-OPEC DCs	13.3	8.2	12.0	19.0	14.7	17.8	2.1	8.6
OPEC	-5.3	10.5	-9.1	4.5	-10.0	5.3	-0.8	-1.9

Source: UNCTAD, "Handbook of International Trade and Development Statistics 1992" (TD/STAT.20) (United Nations publication, Sales No. E/F.93.IID.9), New York, 1993, table 3.1B, p. 65.

404. Both DMECs-DCs and DC-DC trade involve a large number of risks. While these vary according to the specifics of a given situation, they can broadly be grouped along the following lines:

- Buyer defaults;

- Embargo: the contract cannot be performed due to the cancellation or non-renewal of the import licence of the importing party or the imposition of an import restriction;

- Transfer risks: non-receipt of payments in spite of open letters of credit, due to a foreign currency shortage, sudden currency devaluation or currency inconvertibility;

- Non-payment risk: the buyer's bank fails to perform on an open letter of credit;

- Contract frustration: a letter of credit is cancelled prior to delivery when the producer/seller has already engaged substantial means in production and performance;

- Performance risk;

- Supply interruption risk.

405. Insurance for international trade contracts is provided by both public and private underwriters. The Eximbank and the Foreign Credit Insurance Association in the United States of America, COFACE in France, SACE in Italy, the Ministry of International Trade and Industry in Japan, Hermes Kreditversicherungs in Germany and the OECD Export Credit Agencies are examples of public institutions supplying such cover.

406. The International Union of Credit and Investment Insurers associates a large number of public and private insurers in this line of business. The year 1992 was the first since 1983 in which the Members of the Union showed an improvement in their aggregate cumulative position, although still in deficit. By the end of 1992, the Members' exposure in export credit insurance lines was US$ 485 billion, of which 80 per cent related to credit terms of typically less than six months. The balance was employed to finance commerce in capital and quasi-capital goods. Associated members come from 34 countries among which are: Argentina, Cyprus, India, Indonesia, Israel, Jamaica, Republic of Korea, Malaysia, Mexico, Singapore, Sri Lanka, Turkey and Zimbabwe.[3]

407. It has been reported that in Chile, in the first quarter of 1990 and with the incorporation of new companies, new covers are being offered by private non-life sector insurers. These include export credit insurance and other credit covers.[4]

408. Some syndicates at Lloyd's of London have been preparing to offer reinsurance for export credit insurance against default by private-sector buyers. The cover is supposed to be available as from late 1993. Lloyd's already offers political risk covers.[5]

C. Political risk concerning investment in a foreign country

409. Although relatively modest, developing countries do sometimes make investments in other countries, either neighbouring or in the region. Often, mobile assets are located in a foreign country, for example by a construction company. Risks of confiscation, expropriation and nationalization of assets by a foreign government are encountered.

410. On the other hand, many developing countries encourage the local establishment of joint ventures with partners from developed countries. Such partners sometimes perceive a political risk that cannot be contained within the financial framework of the venture and seek political risk cover.

411. Political risk cover for assets in a foreign country is largely provided by public institutions, but may also be purchased on the international market. The ECGD in the United Kingdom and the Overseas Private Investment Corporation (OPIC) - a government agency with an excess of loss reinsurance protection with Lloyd's - in the United States of America are examples of national institutions providing political risk insurance. Usually, cover provided by the public sector is available only for new investment and the investor must apply for the cover prior to investment. Private sector covers are more flexible and can be arranged for existing as well as new ventures, and typically have shorter policy periods than their public sector counterparts.[6]

412. The Multilateral Investment Guarantee Agency (MIGA), an organization of the World Bank established in 1988, provides cover for currency transfer risks, expropriation, war and civil disturbance, and breach of contract by host governments. MIGA insures investments originating in a member country which are destined for a developing member country. Further, MIGA provides advisory services to developing member countries on how to increase attractiveness to foreign investors. The standard policy period is 15 years and approval by the host government must be obtained before MIGA can issue a cover. In 1993, MIGA had 57 operational guarantee contracts supporting projects with a total maximum contingent liability of US$ 745 million. The total subscribed capital amounted to US$ 948 million, of which US$ 189 million were paid in. As of 30 November 1993 MIGA's membership totalled 114 countries, while 29 countries were in the process of fulfilling membership requirements.[7]

413. The European Investment Guarantee Agency (EIGA), in collaboration with the Russian Agency for International Cooperation and Development, has launched a political risk insurance facility for companies investing in the Russian Federation. The facility borrows the underwriting approach of OPIC and MIGA and is arranged by Lloyd's brokers specializing in political risk. The maximum exposure per

investor is limited to US$ 75 million. EIGA plans to create a dedicated insurance company for covering political risk in the Russian Federation as the next phase.[8]

D. Product liability

414. Exports of developing countries to developed countries have reached significant volumes. However, the importers in developed countries often require manufacturers to provide product liability insurance. For example, product liability insurance is demanded for the import of vehicle tires. Some developing countries, in particular India and the Republic of Korea, have made liability insurance available to support their exports.

E. Public and general liability

415. Liability legislation and the practice of claiming compensation from someone who is responsible for causing injury or damage is not yet common in developing countries, with the exception of accidents caused by motor vehicles. However, several developing countries are entering into this line of business.

416. The Public Liability Insurance Act was passed in India in 1991 and requires all manufacturers of chemical and hazardous material to have public liability insurance. Appropriate policy wordings and a rating structure were subsequently designed. Initially the Act met strong protests from the General Insurance Corporation of India as it called for the provision of unlimited insurance cover. An Amendment passed in 1992 limits the liability of the insurer, but not that of the insured plant, to the amount of the policy. The limit was set at Rupees 50 million per incident or 150 million on an annual aggregate per policy. The Amendment initiated the creation of an Environmental Relief Fund to meet the residual liability for the immediate relief to victims.[9]

417. In Thailand, the Insurance Department will propose legislation requiring compulsory cover for producers of toxic substances. The cover aims to reduce the burden of liability, as the potential damage may be beyond the financial means of the plant operators. While the Public Works Act and the Motor Vehicle Accident Victims Act prescribe compulsory insurance for the transport of toxic substances, no such law exists for their production or storage.[10]

418. In the Republic of Korea, four insurance companies are planning to introduce Directors and Officers Liability insurance in the near future. Further, the Insurance Development Institute of Korea has recommended the introduction of Professional Liability insurance to protect victims from wrongdoing and malpractice of doctors, architects and auditors.[11]

F. High technology related risks

419. With the establishment of nuclear-based plants in developing countries, new initiatives are required to be taken by the insurance sector to cover increasingly sophisticated risks.

420. In India, an insurance pool to cover risks relating to the new nuclear activities of the country has been established by five local companies. This pool will cover liability and physical damage. India is the 28th country to establish such a pool.[12]

421. In the Republic of Korea, the management of the Korea Atomic Energy Insurance Pool, set up in 1971 mainly to provide property and liability insurance protection to the nuclear energy industry, was reverted to Korean Re in 1989.[13]

G. Terrorism cover

422. Risks of damage to property due to strikes, riots and civil commotion can be covered as extended perils under a fire insurance policy by endorsement. However, when the magnitude of the breach of the public peace is such that it is a matter of an uprising against the State this extension does not cover the risk.

423. Such a situation was faced in Sri Lanka in 1988 when widespread disturbances took place and the total damage to property came to nearly US$230 million. The decision of the courts was that the losses were not covered under the original policies, so reinsurers were not liable. Consequently, a separate fund was set up in Sri Lanka to cover the risk of terrorism. A separate premium is payable to this fund by all those who purchase property insurance. It is reported that the fund has grown over the years, and currently the risk continues to be covered, but without payment of any premium.[14]

424. In Colombia, the Government has introduced an insurance programme covering bodily injury, death or public vehicle damage from terrorist attacks. The state-owned insurer Compañía de Seguros La Previsora will administer the programme. Terrorism insurance is available on the market as an endorsement to the standard fire policy.[15]

425. Acts of terrorism have also taken place in India and a special insurance to cover the risk has been devised in the market. Property insurance contracts do not usually cover damage by terrorist attacks although policy extensions are obtainable.[16]

H. Kidnapping

426. Particular insurers are willing to underwrite kidnapping risk and issue so-called Kidnap and Ransom (K&R) policies. There is apprehension that the existence of such covers may, in fact, counteract government efforts to fight this crime, thereby creating discord between these insurers and the authorities.

427. Kidnapping cases have increased in recent years in Pakistan. In 1989 more than 500 cases were reported. To meet the situation, insurance companies have devised a cover. Underwriting is on a selection basis.[17]

428. The Government of Colombia is intending to pass legislation outlawing kidnap and ransom payments, thus making K&R covers illegal.[18]

429. Brazil is planning to enact anti-kidnapping legislation, similar to Colombia's, which would outlaw K&R covers. It is reported though that since most of the K&R covers are written in the London market and for executives from developed countries, the new legislation would not have a great effect.[19]

* * *

Notes

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2. UNCTAD, "Handbook of International Trade and Development Statistics 1992" (TD/STAT.20) (United Nations publication, Sales No. E/F.93.II.D.9), New York, 1993, table 3.1A, p. 63.

3. International Union of Credit and Investment Insurers, Press Release 3855B, October 1993, p. 1.

4. World Insurance Report, No. 389, 8 June 1990, p. 4.

5. Business Insurance, 19 April 1993, p. 31.

6. Best's Review, February 1992, p. 44.

7. MIGA Annual Report 1993, 30 June 1993; MIGA membership listing, 30 November 1993.

8. Business Insurance, 23 November 1992, pp. 53-55.

9. The Review, January 1991, p. 46; World Insurance Report, No. 428, 17 January 1992, p. 11; Interlink Reinsurance Consultants, Bombay, correspondence dated 13 March 1992; World Insurance Report, No. 433, 27 March 1992, p. 8.

10. Asia Insurance Review, January-February 1993.

11. Ibid., January-February 1992, p. 12; ibid., May-June 1993, p. 13.

12. L'Argus, 25 August 1989.

13. Asia Insurance Review, January-February 1991, p. 23.

14. World Insurance Report, No. 380, 2 February 1990, p. 10.

15. Business Insurance, 15 March 1993, p. 25.

16. Ibid., 22 March 1993, p. 17.

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18. Business Insurance, 30 November 1992, p. 17.

19. Ibid., 21 December 1992, p. 43.

Chapter VIII

OFFSHORE AND CAPTIVE INSURANCE MARKETS

A. Introduction

430. During the 1970s and 1980s many developing countries expressed hesitation about providing a domicile for captive and offshore companies. Similarly, these countries were reluctant to allow domestic enterprises to form captive and offshore insurance companies, which are generally seen as bypassing the economic mainstream of the country. However, due to a more liberalized international environment and an awareness about a growing globalization of business, a number of developing countries have recently established, or are about to establish, offshore and/or captive centres. The purpose is to attract international insurance business by providing an attractive legislatory environment and good facilities and infrastructure. Tax concessions on profits and investment income, tax-free reserving, liberal incorporation requirements as well as lean supervision and regulation are often provided.

431. For 1992, yearly premiums collected by captives were estimated at approximately US$11.5 billion.[1] Nine per cent of the world's commercial insurance premiums are collected by captives[2] and 35 per cent of the world's industrial insurance is provided by them.[3]

B. Advantages of captive insurance companies

432. Captive insurance companies are set up by parent companies, usually large transnational companies, with several advantages in view. They are seen as a mechanism to reduce insurance costs since control can be exercised over premiums and investment returns, and cost of operations. Covers can be tailored to meet the specific needs of the founding enterprise, and captives can thus be part of a risk management strategy. Profits from insurance operations can be retained within the enterprise group.

433. Through the creation of a captive, the parent company has direct access to reinsurance markets whose resources, prices and expertise it can tap. Control can be exercised over the structure and associated cost of reinsurance, and advantages can be derived from the cash flow arising from insurance operations.

C. Location of offshore and captive companies

434. Certain countries and territories have become offshore centres and provide specific incentives for captive establishment. A relatively liberal regulatory environment in offshore centres makes it possible to channel funds into many national and international investment instruments that yield advantageous returns. Another incentive is the possibility of minimizing the tax liability of the parent's self-insurance programme.

435. When looking for an offshore domicile for its captive insurer, the parent usually seeks the following characteristics:

- Well developed infrastructure, including regular air services to major financial centres, availability of financial services and a good telecommunications system;

- Qualified personnel and administrative services;

- A politically stable environment;

- A flexible and efficient regulatory body;
- Double taxation treaties and taxation arrangements with as many countries as possible, especially countries with developed financial markets;
- A precedent of other captives and/or offshore companies being already established in the same location, and
- Legislative competitiveness, especially regarding the level of taxation on profits, reserves and investment income.

436. It is reported that "today there are more than 20 international offshore financial centres for setting up captives. Worldwide, the number of captives is in the vicinity of 3,000; one hundred are domiciled in Asia, where several new centres have been or are to be established."[4]

437. Some doubt has been expressed as to whether the growing number of offshore locations will all be viable. A successful domicile requires a concentration of diverse financial services where insurance captives play a complementary role.

438. In order to develop regulatory equivalence and acceptable standards and to provide other captive centres with assistance on these issues, insurance supervisors from Gibraltar, Guernsey, Isle of Man, Jersey, Malta, Netherlands Antilles and Panama established the Offshore Group of Insurance Supervisors on 16 March 1993.[5] At a meeting on 20 June 1993 the Group was expanded to include Anguilla, Bahamas, Barbados, British Virgin Islands and Turks and Caicos Islands, while Labuan and Saint Vincent and the Grenadines are observers.[6]

D. Country developments

439. Malaysia has established an offshore financial centre on the island of Labuan. The offshore centre should cater for all aspects of insurance activities, i.e. providing for insurance, reinsurance, broking, underwriting and administrative services. However, offshore insurers operating from Labuan cannot write Malaysian domestic business, though they will be permitted to underwrite reinsurance of Malaysian business.[7] Companies established in Labuan will benefits from double taxation agreements in force between Malaysia and 31 countries, of which as many as 20 have tax-sparing clauses built into them.[8]

440. The first company to set up an operation in Labuan has been Malaysia National Insurance. It is licensed both as an offshore insurer and as an offshore underwriting manager.[9] Further, Malaysia National Reinsurance Bhd. has set up an offshore subsidiary,[10] while the licensing of the first non-Malaysian captive manager is expected to be complete before the middle of 1993.[11] Insurers licensed to operate in Labuan will be allowed to operate management offices in Kuala Lumpur until the end of 1994. This concession is made in order not to hinder the development of Labuan as an offshore centre while infrastructural development takes place.[12]

441. Singapore is trying to attract multinationals to set up a captive operation or a regional captive in Singapore. While at present about three quarters of Singapore-domiciled captives are owned by Australian companies, future captive growth is more likely to come from the United States and Europe, or Japan where high tariffs provide an incentive to companies to set up offshore insurance.[13] The Australian authorities are considering legislation that would nullify the tax privileges enjoyed by Australian captives in Singapore. In response Singapore proposed to consider an increase in its corporate tax for offshore business from 10 per cent to 25 per cent, but this would still undercut the Australian tax rate of 39 per cent, while creating problems for offshore companies of other origins. In a further move the Singapore authorities have suggested giving Australian captives the option of being taxed at the

normal corporate rate of 31 per cent.[14] In further efforts to attract captives, the Singapore authorities have decided to make incurred-but-not-reported reserves tax deductible. The details of the tax status change are still being worked out and it will probably take two years before it is fully implemented.[15]

442. Cape Verde finalized its regulation of concern to captive insurance companies in February 1991. According to the regulation, requirements included establishing a capital reserve account, payment of annual fees and a minimal capital requirement. There was to be no payment of local taxes, no obligation to hold annual meetings, no restriction on export of profits and no obligation to have an office or agent within the domicile. Strict confidentiality laws and minimal reporting requirements were prescribed.[16] In the spring of 1992, the new Government terminated the country's captive status and decided to redirect its limited resources to other areas deemed more beneficial.[17]

443. In the Bahamas, 1992 was the third successive year that the number of captives stood at 31. Their total premium volume decreased in 1991 by 13.1 per cent. Captive managers in the Bahamas feel that faster licensing, a single insurance law and eased regulation concerning work permits would attract more captives.[18]

444. Barbados is trying to extend its network of double taxation treaties in order to maintain and enhance its attractiveness as a captive domicile. This move comes after the Congress of the United States of America voted in 1988 to stop tax concessions to offshore United States companies in Barbados once the current tax treaty expired at the end of 1989.[19]

445. As regards Bermuda, the United States-Bermuda Tax Treaty provides tax exemption to insureds for policies issued by a Bermuda insurer. However, the rules of the procedure have been modified and a tax refund may now be claimed only if the Bermuda insurer was registered in the Bermuda Register of Companies as resident for the whole period for which the refund is sought. Additionally, the risk covered must have been reinsured with an entity also entitled to the benefits of the treaty.[20]

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Notes

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3. The Review, May 1989, p. 21.
4. Asia Insurance Review, March-April 1991, p. 10.
5. World Insurance Report, No. 464, 18 June 1993, p. 8.
6. Ibid., No. 466, 16 July 1993, p. 7.
7. World Insurance Report, No. 393, 3 August 1990, p. 5.
8. The Review, November 1991, pp. 49-51.
9. Asia Insurance Review, January-February 1992, p. 7.

10. World Insurance Corporate Report, No. 101, 11 September 1992, p. 16; Asia Insurance Review, January-February 1993, p. 27.

11. Business Insurance, 26 April 1993, p. 93.

12. World Insurance Report, No. 437, 22 May 1992, p. 5; Asia Insurance Review, May-June 1993, p. 12.

13. Asia Insurance Review, September-October 1991; Business Insurance, 30 March 1993, p. 96.

14. World Insurance Report, No. 387, 11 May 1990, p. 8; ReActions, January 1992, p. 19.

15. Business Insurance, 26 April 1993, p. 95.

16. Risk Update DYP, January 1992, p. 5.

17. Business Insurance, 26 April 1993, p. 95.

18. Ibid., 26 April 1993, p. 82.

19. World Insurance Report, No. 366, 7 July 1989, p. 8.

20. Ibid., No. 361, 28 April 1989, p. 8.

Chapter IX

NATURAL CATASTROPHES

A. Introduction

446. We may define natural catastrophes as large-scale damage caused by a wide scope of natural perils, such as earthquake, volcano eruption, windstorm, flood, bush fire, etc. Natural catastrophes can produce a large number of individual losses as a result of a single incident. They may be in a specific location or spread over a wide area. Natural catastrophes have become one of the most discussed insurance subjects for two reasons. First, in recent years their frequency has been increasing, which has resulted in a corresponding increase in the cost of cover and reduced the maximum sum insured per event which the catastrophe reinsurance market is able to absorb. Secondly, urban development has resulted in a higher geographic concentration of ever larger and more valuable risks. The increase in frequency of catastrophic events combined with higher values at risk has increased demand for catastrophe covers.

447. Climate changes may also produce catastrophes and could generate large, far-reaching economic and social effects. In 1990 Swiss Re stated "Apart from population development, climate development may also have a decisive influence on the frequency and extent of damage of natural catastrophes. The greenhouse effect, i.e. the global warming of the earth as a result of changes in the earth's atmosphere regarding carbon dioxide, nitric oxide and CFCs or chlorofluorocarbons, are brought up in many discussions as causes of the increasing frequency of natural catastrophes. Some indicators seem to support this argument: it is relatively certain today that hurricanes developing in Central America in the next few years will be pushed further and further northwards due to the warming of the earth's atmosphere. However, the generally increasing frequency of such events cannot yet be adequately supported by evidence. In addition, a comparison of the climate development over several decades or even centuries makes the temperature changes measured in recent years relative. The current position in discussions could be roughly summarized as follows: the greenhouse effect will very probably have important consequences for the earth in general and the insurance industry in particular over the next few years and decades. When, where, and to what extent these consequences will manifest themselves cannot, however, be evaluated conclusively as yet."[1]

448. Similar opinions are held by other members of the industry. The general view is that it is too early to say whether global warming is occurring and, if so, it is due to the greenhouse effect or whether the current changes are merely natural temperature cycles. The international reinsurers' view on causation would appear to be summed up as: "We don't know, but we can't afford to wait to find out."[2] It has been suggested that hurricane activity would double with a 1 per cent rise in temperature, while a 3 per cent rise would increase their destructive power by 40 per cent.[3] If a majority of reinsurers subscribe to this view of gradual temperature rise, an increase in catastrophe insurance rates seems inevitable.

449. According to the World Meteorological Organization, global warming is linked to the greenhouse effect and climate change can be expected. However, it is still unclear whether the actual frequency or severity of storms will increase.[4]

450. The adverse effects of the environment was evidenced by a series of events in the Asia Pacific region in 1991. Examples are the April impact of cyclone "Gorky" in Bangladesh, the June-July rainfall and resulting floods and landslides in China, the November strike of tropical storm Thelma in the Philippines and cyclones off the coast of Viet Nam in late December.[5] Further, 1992 saw heavy storms, typhoons, monsoon rains and flooding in virtually all South-East Asian countries. Heavy monsoons and flooding caused an enormous loss of life in Pakistan, north India and north Afghanistan.[6]